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ECONOMICS FOR COMPETITIVE EXAMINATIONS

Author

SYLLABUS

Economics for Competitive Examinations

BLOCK I: ECONOMIC DEVELOPMENT AND ENVIRONMENT	
Unit-1: Economic Development - Measurement of Development - Causes of under Development. **Unit-2:** Development and the New Economic Policy. **Unit-3:** Development and the Environment.	**Unit 1:** An Overview of Economic Development **(Pages 1-32);** **Unit 2:** Development and the New Economic Policy **(Pages 33-54);** **Unit 3:** Development and Environment **(Pages 55-68)**
BLOCK II: POPULATION - POVERTY AND SOCIAL WELFARE	
Unit-4: Population: Population Growth - Age Composition of Population. **Unit-5:** National Population Policy - objectives - targets. **Unit-6:** Poverty: Measurement of Poverty - Types - Poverty Line - Disadvantages. **Unit-7:** Social Welfare Programmes: Policies for Poverty and Unemployment Problems.	**Unit 4:** Population **(Pages 69-88);** **Unit 5:** National Population Policy **(Pages 89-110);** **Unit 6:** Poverty **(Pages 111-124);** **Unit 7:** Social Welfare Programmes **(Pages 125-162)**
BLOCK III: PRICE, MONETARY AND FISCAL POLICY IN INDIA	
Unit-8: Price Policy and Inflation History to Price Rise in India - Causes of Inflation. **Unit-9:** Price Control Mechanism in the Post - Reform Period. **Unit-10:** Monetary Policy in India - importance - effects. **Unit-11:** Fiscal Policy in India - importance - effects.	**Unit 8:** History of Inflation and Price Policy **(Pages 163-178);** **Unit 9:** Post-Reform Period of India **(Pages 179-190);** **Unit 10:** Monetary Policy in India **(Pages 191-204);** **Unit 11:** Fiscal Policy in India **(Pages 205-216)**
BLOCK IV: INTERNATIONAL ECONOMIC AND ORGANISATIONS	
Unit-12: International Economic Co-operation: OECD - SAARC - EEU - BRICS. **Unit-13:** International Finance Institutions: World Bank - IMF - ADB. **Unit-14:** International Trade Organizations: UNCATD - GATT - WTO - OPEC.	**Unit 12:** International Economic Co-operation **(Pages 217-231);** **Unit 13:** International Finance Institutions **(Pages 232-257);** **Unit 14:** International Trade Organizations **(Pages 258-276)**

CONTENTS

INTRODUCTION

NOTES

The term economic growth is used to refer to sustained increase in a country's output of goods and services, or more precisely product per capita. Output is usually measured in terms of GNP. The term economic development is far more comprehensive, implying progressive changes in the socio-economic structure of a country. Every country in the world strives for economic development so as to have an over better life condition and living standards. Understanding of the concept of economic planning in the context of environment and developmental factors is extremely crucial.

The policy making at the National and the state levels for economic development must be inclusive of concerns like population, poverty, unemployment price, inflation, etc. Studying the underlying causes of these problems and then making of new efficient plans for the citizens is important. This will include tools like fiscal and monetary policies.

Further, planning at the national level will not be enough. The world has become globalized now. And the countries must take advantage of economic, financial and trade cooperation so as to better the policies and economic functioning in their country in tandem with the world. All of these topics will be discussed in this book. These topics will make the students be abreast with the relevant topics of economics and make them fair well in competitive exams.

The book, *Economics for Competitive Examinations*, is divided into fourteen units that follow the self-instruction mode with each unit beginning with an Introduction to the unit, followed by an outline of the Objectives. The detailed content is then presented in a simple but structured manner interspersed with Check Your Progress Questions to test the student's understanding of the topic. A Summary along with a list of Key Words and a set of Self-Assessment Questions and Exercises is also provided at the end of each unit for recapitulation.

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BLOCK I
ECONOMIC DEVELOPMENT AND ENVIRONMENT

UNIT 1 AN OVERVIEW OF ECONOMIC DEVELOPMENT

Structure

1.0 INTRODUCTION

A country's economic growth is usually indicated by an increase in that country's gross domestic product or GDP. Generally speaking, gross domestic product is an economic model that reflects the value of a country's output. In this unit, you will learn about economic growth and economic development. Economic growth is the positive change in the real output of the country in a particular span of time. Economic Development involves a rise in the level of production in an economy along with the advancement of technology, improvement in living standards and so on.

Further on, the concept of national income measurement will be delved into. The most popular and old method is by measuring the Gross National Product or Per capita Income. Some other measures are also available for measuring economic development. The most important amongst these are the Human Development Index and Physical Quality of Life Index. The characteristics of underdeveloped economy and the causes behind the state will also be discussed.

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1.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the concept of economic growth and economic development
- Understand the various ways of measuring economic development
- Analyse the prevalence of underdevelopment in different countries

1.2 ECONOMIC DEVELOPMENT

Although in common parlance, there is no difference between economic growth and economic development and these terms are used interchangeably, in economics, we differentiate between the two concepts. Economic growth is a narrower concept between the two and denotes an increase in the country's Gross Domestic Product.

There are two common measures of the rate of economic growth. The first is the rate of growth of a nation's real Gross Domestic Product, which tells how rapidly the economy's total real output of goods and services is increasing. The second is the rate of growth of per capita real Gross Domestic Product, which is a better measure of the rate of increase of a country's standard of living.

To represent the process of economic growth, it is convenient to use the production possibilities curve which shows all efficient combinations of output that an economy can produce. For example, let us suppose that a given society produces only two goods: food and tractors. If this society has at its disposal a fixed amount of resources and the technology is fixed, the production possibilities curve shows the maximum quantity of food that can be produced, given each amount of tractors produced. This is shown in Figure 1.1.

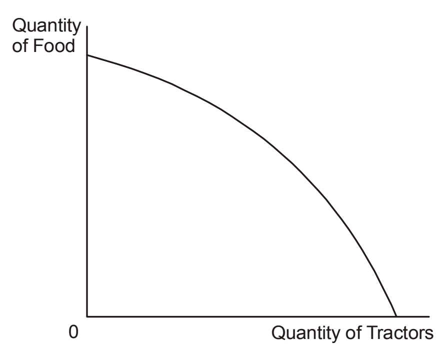


Figure 1.1 Production Possibilities Curve

The production possibilities curve shows all efficient combinations of output that an economy can produce.

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Shifts of the Production Possibilities Curve

A country's potential output increases when its production possibilities curve shifts outward, as explained in Figure 1.2 where the curve shifts from position A to position B. This happens because the society can produce (and consume) more of one good without having to produce (and consume) less of the other good. Thus, its productive capacity must be greater. If the production possibilities curve shifts outward, the economy is efficient, and the population remains constant, the per capita GDP increases, thus facilitating economic growth. Moreover, the faster the production possibilities curve shifts outward, the greater the rate of economic growth.

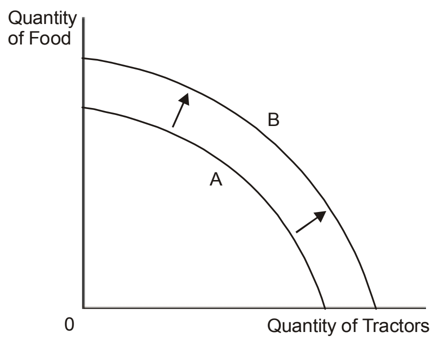


Figure 1.2 Outward Shift of Production Possibilities Curve

No Shift of the Production Possibilities Curve

A general decline in the unemployment or inefficiency level will cause economic growth even if the country's production possibilities curve does not shift outward. If a country allows some of its resources to be unemployed or underutilized because of an insufficiency of intended spending, this will cause the economy to operate at a point *inside* the production possibilities curve rather than *on* the curve.

Now, it is clear that economic growth has a connotation of quantitative expansions in economic variables, especially aggregate and per capita. National income is measured by GNP and NNP. Therefore, the analysis of economic growth is concerned mainly with the measuring of growth in economic variables and identifying their interrelationships. For example, it concerns itself with the interrelationship between the national income growth rate and the speed of capital formation.

Economic Growth vs Economic Development

Economic development is usually concerned not only with quantitative expansions, but also with changes in non-quantitative factors such as institutions, organizations and culture under which economies operate. If we follow this usage, economic growth is considered to be a quantitative aspect of economic development.

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1. In broad terms, one would say that economic development involves a steady and ongoing activity that leads to a better standard of living and improvement in the financial health of a particular sector or an area of a country's economy. Economic development also signifies the quantitative and qualitative changes that take place in the economy. Such actions can include the development of human capital, critical infrastructure, regional competitiveness, environmental sustainability, social inclusion, health, safety, literacy, and other initiatives.
2. The concept of economic growth is much narrower than the concept of economic development. As we have already studied, it implies an increase in a nation's real level of national output which could have been brought about by an expansion in the resource quality or quantity, technological improvements, etc. The principle of economic development is normative. This means that it finds application in the context of people's sense of morality (right or wrong, good or bad). Michael Todaro, an American economist and a pioneer in the field of development economics, equates economic development with increasing standards of living, better self-esteem, and other privileges such as freedom from any and all kinds of exploitation, etc.
3. Economic growth will take place upon a gradual increase in any or all elements that make up the GDP such as consumption, investment, government expenditures and net exports. Economic development, on the other hand, involves an increase in the Human Capital Index, a notable decline in social and economic inequality, and structural changes that contribute to a basic improvement in the overall quality of a nation's population. It must be noted that one of the most precise ways of determining economic development is by using the Human Development Index. This Index includes the literacy rates and the growth of more employment opportunities in various sectors such as education, healthcare, employment and the protection of the environment. This denotes that all citizens of the nation experience a growth in their per capita income. Other measures of economic development include gender related index, human poverty index, infant mortality rate and literacy rate.
4. Economic growth pertains to an increase in the output of an economy, whereas economic development pertains to structural changes that take place in an economy.
5. Economic growth is a quantitative measurement relating to an increase in Gross Domestic Product and shown Production-possibility Frontier. Economic development is measured in qualitative terms. In other words, economic growth is associated with bringing about quantitative changes in an economy, whereas economic development is associated with bringing about qualitative changes in an economy.

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6. In order to measure progress in developed nations, economic growth is a much preferred indicator. Most nations make use of it for measuring fiscal growth since growth is a pre-condition for development. Developing countries make use of economic development in order to measure progress and quality of life.
7. There are several unrecorded economic activities that characterize an economy. These activities go unaccounted for in the measurement of economic growth. These activities are related to an informal or a black economy. Economic development helps in alleviating people from low standards of living with the provision of proper employment and suitable shelter.
8. A major problem with economic growth is not taking into account the exhaustion of natural resources that may cause pollution, congestion and the occurrence of various diseases. The concept of development, on the other hand, is synonymous with sustainability, referring to meeting present needs without having to compromise the future needs.
9. Economic growth is an important, but not an adequate condition of economic development.

We can say that development economics is that branch of economics that deals with the economic aspects of development process in nations with low incomes. Development economics focuses not only on methods that encourage economic growth and structural changes, but also on the improvement of the potential for the mass of the population.

Generally, economic development is concerned with growth in such metrics as literacy rates, life expectancy and poverty rates. GDP disregards other important components such as leisure time, environmental quality, freedom or social justice. There are other ways of measuring the economic well-being of a nation. In a fundamental sense, the economic development of a nation appertains to its human development, which includes, among other things, health and education. These determinants are, nevertheless, closely linked to economic growth in such a way that economic development and economic growth are complementary concepts.

Factors Affecting Economic Growth

Broadly speaking, there are chiefly three important areas encompassed by the policies of economic development:

- Governmental measures undertaken to fulfil broad economic objectives like price stability, high employment and a sustained rate of growth. These efforts allow for changes in economic and fiscal policies, the governance and administration of financial institutions, trade and tax policies, etc.
- Procedures that offer infrastructure and services such as highways, parks, affordable housing, crime prevention and school education.

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- Job creation and retention through specific efforts in business finance, marketing, neighbourhood development, workforce development, small business development, business retention and expansion, technology transfer and real estate development.

An Overview of Capital Formation

Just as there is no single social or economic indicator that fully defines a developing economy, there isn't just one factor that is responsible for economic backwardness. The barriers to development encountered by different nations vary widely. While one developing nation may have abundant natural resources and a severe population problem, another may lack natural resources. However, there are several common obstacles to development, some or all of which may apply to a given nation. The future economic growth depends on a nation's success in developing and applying policies designed to overcome these barriers.

Developing nations must be especially concerned with increasing the capacity of their productive resources and using these resources efficiently. In a general sense, economic development depends upon the following:

(a) The resource base (natural, capital, and human)
(b) The institutional environment
(c) Technology, which influences resource utilization and allocation

Our task here is to identify the chief reasons as to why nations are underdeveloped. Clearly, we are faced with a special case of the process of economic growth.

Capital Formation and Technological Change

Economists have, for very good reasons, emphasized the lack of investment in capital resources as an obstacle to economic development. Saving and investment from current consumption is one central determinant of the rate of economic growth. Today, the more rapidly growing nations are those that are achieving high rates of capital formation. The output produced by ₹1 of capital investment, as reflected by the productivity of capital (the output/capital ratio) is dependent upon a host of qualitative and vaguely understood growth factors, all of which are mutually interdependent. However, poor nations do not have a large stock of capital resources relative to labour. Further, technological changes cannot take place in the absence of capital resources, thus impeding progress further.

Net Investment and Capital Formation

Any level of output or income can be in used two ways; a population can consume or it can save and invest. The consumption-goods sector uses resources to produce for current sustenance and the capital-goods sector uses resources to produce physical capital for indirect consumption and future production.

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But what is investment other than the obvious 'absence of consumption'? A narrow, but perfectly valid view regards net investment as the accumulation of physical-capital goods such as shovels, machines and factories—the formation of a stock of physical-capital resources. Physical-capital formation is just as characteristic of primitive societies in which equipment such as hoes and shovels are produced as it is of more modern economies that produces computers, machine-tool lathes and diesel trucks. The more complex and advanced economy, however, devotes a good deal of investment to physical capital that is capable of reproducing itself. Thus, for example, machine-tool industries are useful in producing physical-capital as well as consumption goods. Without physical-capital resources, a society would revert to a peasant agrarian economy and would be unable to transfer human resources out of subsistence farming. Moreover, in the absence of investment, it would be virtually impossible to transform resources into output and efficiently use technological processes which now dominate such activities as farming, building boats, or mining—all of which are simple handicraft industries in certain nations. Net physical-capital formation allows a society to perform more tasks more efficiently with man-made aids to production. Thus, by adding to the quantity and quality of its capital resources through investment, a nation can enhance its growth potential. For this reason, investment represents a focal point in the study of economic development.

Economists also focus on investment as an ingredient of growth because a growing society must devote substantial amounts of resources to the elements that work together to further growth. A portion of a nation's resources are 'invested' in educating human resources, and human capital is formed. Vast amounts of resources may also be invested in scientific research and development efforts to find new ways of improving life through technological change. Investment also reclaims once-deteriorated natural resources such as eroded and barren soil or depleted fisheries, and aids in the discovery of new resources such as timber, oil or minerals. Furthermore, investment in social overhead capital—communication and transportation systems, schools and medical clinics—also facilitates economic development.

The crucial point is that investment (whether in physical capital, human capital, research and technical change, exploration for natural resources, or the improvement of institutions) is a key requirement in the enlargement of a nation's productive capacity. This does not mean, of course, that investment is the cause of economic growth; rather, investment is one of several crucial elements in the growth process.

Low rates of saving and investment, and rapid population growth are major dimensions to the economic ailment called 'underdevelopment,' and the way in which these factors interact is vital to understanding the problem. Before we discuss the many other interrelated variables that act as obstacles to economic development, it is worthwhile to see how investment, the output/capital ratio and population growth interact to help determine growth in per capita income.

Capital Resources and Investment

Economic growth requires that ample natural and human resources are accompanied by the physical-capital component—the 'tools' used to develop and utilize these other resources. The contemporary economic process of producing and exchanging goods and services is highly specialized and circular, and numerous production stages and large amounts of capital resources are involved in the most effective technological methods of converting resources into outputs. The historical record in developed nations provides a clear indication that there is a positive relationship between a nation's stock of capital goods and its economic growth.

Not too long ago, some economists emphasized investment in physical capital such as tools, machinery and buildings. A literal interpretation of capital formation to mean physical-capital assets alone is too narrow a view of the process of economic growth. However, saving and investment for all 'capital' purposes, when broadly viewed, is without question a most vital growth component. Technological advancement often requires investment in new equipment and machines. In addition, investment in research and development often represents the technology and capital formation of tomorrow. The education of human resources is, in part, an investment process in which unskilled and relatively untrained labour is transformed into human capital. The natural-resource base depends heavily upon investment for acquisition and discovery, as we noted earlier. Thus, the capital-formation process is a multi-faceted dimension to economic growth and one that facilitates the use and development of all aspects of mankind's environment.

Sources of Capital Formation

Capital is available from two sources: domestic and foreign. The domestic source consists of savings and resources raised by government in the form of taxation and profits of government enterprises. We discuss these recourses one by one.

(I) Savings

Savings are generated by all the three sectors in an economy. The business sector's savings consists of retained profits and reserve fund. Household sector generates the maximum amount of savings only if the level of income is high. In India nowadays, the household sector generates about twenty-five to thirty per cent savings. The third sector is the government sector which generates negative savings. This is because of the fact that the government's expenditure is more in comparison to government's income. Savings can be generated only: (i) if there is a will to save (ii) an opportunity to save, and (iii) an incentive to save.

(II) Taxation

For a variety of reasons, most economists have argued that domestic savings for national development can be increased only by government's compulsorily reducing (by taxes but also in other ways) the personal consumption of the citizens. These

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economists can point to the difficulties of raising the level of voluntary savings—the low incomes of a large proportion of the population, the attempt to attain the levels of consumption of people in the highly developed countries, the fear of price increases undermining the real value of savings, political misgivings, and so on. Budget surpluses played a crucial role in the early stages of Japan's economic development, and have provided the favourite example to be paraded before other developing countries wishing to emulate its success.

Even if voluntary savings alone could do the job, they are not favoured by a number of economists. They argue that while the investment of tax revenue in development creates no claims on future increases in output, private savers will hold such claims in the form of bonds and other savings media. The servicing of this internal debt, it is argued, will cramp the government's revenue and expenditure policy in the future.

Most economists have advocated a development strategy aimed at raising the level of domestic savings through budgetary policy, i.e., reducing personal consumption by increasing taxation while ensuring that this increased revenue is not used to increase government consumption or defence, civil services, etc. Their advocacy has in one respect been very successful. Major internal inquiries have been undertaken; independent reports by tax consultants have been solicited; in appraising the economic performance of their member countries, the International Monetary Fund and the World Bank attach great weight to this aspect of a country's economic policy. So significant is it in the eyes of many people and institutions interested in economic development that the ratio of tax revenue to Gross National Product (GNP) is treated as one of the most important criteria for measuring and judging a country's economic performance.

Nor has this great taxation effort lacked results. In many countries, governments have shown a high degree of political self-discipline in introducing new tax measures and in increasing revenue yields.

Thus, we see that the government can generate the savings through taxation. This potential of savings depends upon the following:

(i) The level of per capita income
(ii) Inequality in the distribution of income
(iii) Administrative powers of the government

If we look at the history of taxation in different countries, we find that the government increased the rate of taxation to such an extent that no incentive had been left for earning the income. This phenomenon has been explained by the Laffer curve. Moreover, with the increase in the amount of taxation, the government has increased the expenditure. Consequently, there was less that was available for capital formation in the country.

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(III) Profits of Public Enterprises

In the beginning of the development of a country, the government itself tries to establish the enterprises in the public sector with the purpose of:

(i) Increasing the production of certain goods which require a large-scale capital investment

(ii) And which could generate a profit for the government

If we take an example of India, we find that most of the capital intensive enterprises have been established in the government sector. These enterprises have generated the profit for the government, but have been unable to generate as much savings. However, this is still a good source of savings.

(IV) Increase in Money Supply

An increase in money supply generates savings. In most of the developing countries, development took place because of savings generated by money supply. Central banks extend the loans to commercial banks and commercial banks, in turn, extend loans to the public. Through the extension of loans, the public gets the funds. These investments create income, which generates both consumption as well as savings. In this process, first investments are generated and afterwards savings are created. This type of investment through the creation of money supply was advanced by Keynes. This concept is quite different from the classical concept of savings, which is expressed in real terms. According to the classical economic theory, investment is possible only when savings are generated first.

(V) Foreign Sources of Capital

The underdeveloped nations also rely on capital from abroad. Foreign capital accounted for much of the progress of the United States during its first century of development. In recent years, increased grants and loans from the governments of more highly developed nations and international agencies, as well as private capital flows to underdeveloped nations, have aided the capital-formation process.

Underdeveloped nations often impose restrictions on capital from abroad to avoid foreign control and well-remembered colonial exploitation. The pre-World War I imperialism brought advantages and disadvantages to underdeveloped regions of the world, and one of the decided disadvantages was the occurrence of an imbalanced economy in some countries. Foreign capital inflows conflict with the spirit of nationalism so prevalent in the underdeveloped world today, partially because foreign capital moves into the most profitable economic activities, a situation which may not favour the economic independence and future growth of an underdeveloped nation. When a nation needs to diversify its economy and develop stronger domestic markets, foreign capital will not be beneficial if the lopsided economic base common to past imperialism is perpetuated.

The risks associated with political and social instability as well as the infrequent threat of nationalization discourages investment by foreigners. Other barriers to

foreign investment are the absence of developed markets and the lack of the leadership and organizational skills common to the risk-taking, entrepreneurial middle class found in the developed nations. In the absence of a class that is able to mobilize and administer the use of capital resources, an element vital to the process of economic development is missing.

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Causes for Low Rates of Capital Formation

Domestic capital accumulation requires that a nation allocate resources to future goods through saving and investment from what would otherwise be current consumption. The prospects for domestic saving in developing countries are often limited. Then, too, saving is difficult when income is unequally distributed, as it is in many poorer countries. The wealthy landowners as well as the political and industrial elite with large saving potentials often hoard property or precious metals instead of investing. They may also spend vast sums for a standard of luxury, which contrasts sharply to the poverty of the masses. The wealthy often invest their savings abroad where safety and stability are more assured, and this is one reason that social and political factors have an important bearing on a nation's prospects for economic development. Yet another important impediment to domestic capital formation is the instability of and a frequent lack of faith in domestic banking institutions and government. When the value of a domestic currency or a monetary system is questioned, funds are quickly channelled abroad or into assets such as property or gold, instead of risky capital equipment. In essence, domestic capital formation is meagre because both incentives and opportunities of investment are poor. Broadly, the causes for low rate of capital formation are as follows:

- Low rate of savings
- Equal distribution of income
- Hoarding
- Investment at foreign shores
- Instability in banking system
- Poor incentives and opportunities to invest

Check Your Progress

1. What are the two common measures of the rate of economic growth?
2. State two causes for the low rate of capital formation.

1.3 MEASUREMENT OF DEVELOPMENT

There are various measures of development. Depending on the need, different measures can be used. In this section, you will learn about the measures of GNP, National Income, PQLI, HDI, etc. The aggregate income of a society can be estimated by measuring either expenditures for goods and services or payments

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made by firms to factors of production. The first step in national-income measurement is to understand the concept of income. Then, we shall review the actual process of measurement and proceed to study alternative income accounts.

Gross National Product (GNP)

The broadest measure of a nation's total income is the Gross National Product (GNP)—a measure of the market value of all final output produced over a period of time. It is generally agreed that GNP is a reasonable indicator of the health of an economy, although there are several shortcomings to this measure.

The market value of goods and services denotes GNP, because market prices represent the value of final output. The measurement of the market value of final output excludes some non-market transactions—such as the labour of a housewife or a husband's handyman services—from GNP. Note, too, that GNP is a measure of the final output only. Second-hand sales are excluded because the resale of a home, automobile or appliance represents final output which has already been counted. Purely financial transactions, such as the exchange of securities, are excluded from GNP because the exchange of title to assets represents no new output. Finally, transfer payments from the public sector to firms or individuals are excluded from GNP on the grounds that these transfers merely denote 'income switching'. This can be indicated as follows:

Expenditures = GNP = Income Payments

It is possible to measure the value of a nation's gross output either as expenditures for output or as income payments to the four factors of production, as Figure 1.3 shows.

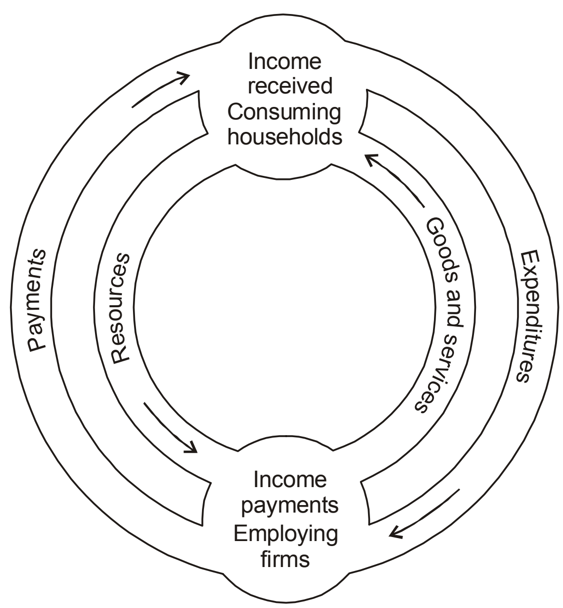


Figure 1.3 Circular Income Flows

Income Flows: Producers pay resources owners (who are also consumers) for their contribution to production. Consumers spend their incomes on goods and services sold by producers. Consequently, national income can be measured as the sum of all expenditures on output or as the sum of all payments to resources.

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In the expenditure context, GNP is made up largely of household consumption expenditures, business investment expenditures, and government purchases of goods and services. In the context of income payments, GNP is the sum of wages, salaries and profits earned by human resources, rent and interest payments to property resources, and two types of non-income payments, i.e., the value of capital resources used up or 'consumed' in production, and indirect business taxes.

The dual nature of income receipts paid to resources and income expenditures for output is important. The circularity of income flows is illustrated in Figure 1.3 for a simplified economy consisting only of consumers and producers (actually, households, firms, government, and other nations are consumers of a sort, since they purchase a nation's output). Assuming the existence of only consumers and producers, Figure 1.3 demonstrates that *actual* income payments to resources must exactly match *actual* expenditures on output. Total income can be measured either way because we are talking about the same event—exchange between sellers and buyers of outputs and inputs. Everything spent for output represents income flowing back to producers that is later paid to resource owners. Any output produced and not sold is treated as if it were purchased by the producer who maintains an inventory of goods. Thus, the amount that firms receive as income represents the expenditures of consumers on a nation's current output. Similarly, the total of all payments made by producers to resource owners represents the value of a nation's output. Thus, a second and equally valid alternative for measuring GNP is to total the payments made by producing firms to all productive resources.

GNP Value Added

An accurate measurement of GNP demands that the value of goods and services produced is measured only *once* and not a number of times as goods pass through various stages of production. For example, it is inappropriate to add the total market transactions involved in production. Double counting appears in summing gross expenditures for corn to feed cattle plus expenditures for cattle hides sold to leather processors who sell to shoe manufacturers, and so forth. Instead, GNP measures the value added by making payments to resources in each production stage. The examination of a simplified input-output model of an economy is the easiest way to understand the idea that GNP value added.

Suppose there are two industries producing agricultural and manufacturing goods. Both industries employ factors of production or inputs, generally identified as a 'bundle' of resource inputs, as shown in Table 1.1. In the figure, both manufacturing and agriculture appear as sellers of output (read by row) and purchasers of inputs (read by column). Reading across by row shows that ₹120 of manufacturing output is sold to manufacturing for further processing, another

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₹200 of manufacturing output is sold to agriculture, and ultimately ₹180 of manufacturing output is sold to consumers as final goods and services. These consumption purchases are financed by households that receive income payments for supplying resources to producing firms. Table 1.4 shows that manufacturing and agriculture are also purchasers of intermediate output of goods used in producing goods and services.

Table 1.1 Input-Output Illustration of GNP Value Added

	Manufacturing Purchase	Agriculture Purchase	Final Consumer Demand	Gross Sales of Output
Manufacturing sales	120	200	180	500
Agriculture sales	80	40	220	340
Payments to resource inputs	300	100	400=GNP	
Gross purchases of input	500	340		840

Final Output: The final output of a nation excludes intermediate transactions as goods move through the production process. Therefore, gross sales (or purchase) and large that GNP which is the value added in production, the sum of all payments to resources and the sum of final consumer demand expenditures (₹ 400 billion).

Over a period of one year, manufacturing, for example, buys ₹120 of its own output, another ₹80 of output from agricultural firms, and ₹300 of resources used to produce goods. Similarly, agricultural firms buy ₹200 + ₹40 + ₹100 worth of inputs (read by column) and sell ₹80 + ₹40 + ₹220 worth of outputs (read by row). Now let us see what we can learn from this model.

GNP can be estimated by summing either of the income payments to all resources of expenditures for final output. Either way, we are measuring only the current final market value of goods and services produced.

Accounting for GNP

Having concluded that GNP is the sum of expenditures on final output or aggregate factor-income payments, let us examine the four main types of expenditures that comprise GNP: consumption *(C),* gross investment (*I*), government purchases of goods and services (G) and net exports (Ex). Final output or GNP is the sum of C + I + G + Ex, where each expenditure component is a composite of a variety of expenditures.

(I) Consumption (C)

Consumption outlays are largely household expenditures for services (haircuts and attorney's fees), durable goods (automobiles and appliances), and non-durable goods (clothing and food). In measuring consumption expenditures, national-income accountants also include estimates of the value of food grown and consumed by farmers as well as the rental value of owner-occupied housing.

(II) Gross Investment (I)

Although gross investment expenditures are not as large as consumption, they are an important expenditure component. This is because investment varies considerably from one time to another. Gross investment consists of total expenditures for plants, production equipment, all types of construction and changes in business inventories, which reflects additions to or deletions from prior inventory levels arising from the difference between sales and production for a given year. Since double counting would be evident if total inventory stocks were used year after year, the change in inventory stocks is used.

(III) Government Purchases (G)

Expenditures for the goods and services purchased by the government are also included in the GNP. However, interest on the government debt, transfer payments to households such as unemployment compensation or social security payments, and business subsidy payments are excluded from the GNP. National-income accountants are interested only in payments for current production. Pensions, relief payments, subsidies, or interest payments on government bonds are simply transferred between households and firms and do not represent expenditures for current production. Since government purchases include only the actual purchase of goods and services, budget for all government expenditures will be larger than the G component in GNP by the amount of transfers and interest payments.

(IV) Net Exports (Ex)

Most nations trade goods and services with other nations. The portion of a nation's output sold to foreign countries is gross exports, whereas the purchases from other nations are gross imports. Net exports consist of gross exports less gross imports, and may, therefore, be negative or positive. If gross exports exceed gross imports, net exports are positive; but if gross imports exceed gross exports, net exports are negative, meaning that on balance a nation has spent funds for output that has been produced abroad.

Five Income Accounts

Now that we have some knowledge about the procedure for estimating GNP as a measure of a nation's final output, we can briefly identify five income accounts commonly used to measure economic activity. These five income accounts are

NOTES

used for different purposes. Let us start with GNP, and subtract or add the requisite items to each account as shown in Table 1.2.

Table 1.2 Five National Income Accounts (billions of dollars)

	Income account definition	1970	Income account entries
1.	Gross income or output-created: GNP	₹971	Gross National Product (C+I+G+Ex)
		– 84	(less depreciation of capital stock)
2.	Net income or output-created: NNP	₹ 887	Net National Product
		– 89	(less indirect business taxes)
3.	Net income earned by resources: NI	₹ 798	National Income
		– 78	(less corporate profits)
		– 55	(less social security taxes)
		+ 57	(plus dividends and interest)
		+ 79	(plus transfer payments)
4.	Net income received: PI	₹801	Personal Income*
		– 117	(less personal taxes)
5.	Disposable or spendable income: DI	₹684	Disposable Income
		632	Consumption**
		52	Savings

*Includes interest paid by consumers and government.
**Interest paid by consumers is also included in consumption expenditures.

1. *Gross National Product (GNP):* A nation's market value of all final output or income produced in a year, identified as GNP, is defined as the sum of expenditures for consumption, gross investment, government purchases, and net exports. This can be expressed as follows:

$$\mathbf{GNP = C + I + G + Ex}$$

2. *Net National Product (NNP):* NNP measures net income or output created, or gross output less depreciation (D) of capital resources. NNP differs from GNP because some investment expenditures replace the capital equipment depreciated in any given year. Buildings, machinery and trucks do not have an infinite life and each year of use results in more wear and tear, or depreciation of capital resources. Another way to view NNP is to add net, and not gross investment to $C + G + Ex$. The difference in gross and net investment is *capital consumption* or *depreciation* for a year. As long as continued production uses up some portion of existing capital resources, future productive capacity is impaired. Therefore, NNP is a more accurate measure of a nation's net annual output than GNP.

$$NNP = GNP - D \text{ or } (G + Inet + \mathrm{G} + \mathrm{Ex})$$

3. *National Income (NI):* In order to measure income earned by all resources used in the production process, indirect taxes are subtracted from NNP. In short, national income measures the market costs of economic resources used in producing a year's output. We derive *NI* by subtracting indirect

business taxes (such as sales or excise taxes on tobacco, gasoline or liquor) from NNP. Indirect taxes (Ti) represent a cost of doing business, but they are not regarded as a payment to a factor of production. We have the following equation:

NI = NNP – Ti

4. *Personal Income (PI):* Sometimes, it is helpful to know the total income received by all persons, a measure denoted as *PI.* Personal income is derived by subtracting two items from NJ: corporate profits (P) and social security taxes (Ts). None of these represents income received by persons. It is then necessary to add dividends and interest payments *(di),* plus all government transfer payments *(tr)* such as retirement benefits, unemployment compensation, welfare payments and interest payments. Thus, we obtain the following equation:

PI = NI – P – Ts + di + tr

5. *Disposable Income (DI):* Finally, the amount of income available for spending is personal income less personal taxes *(Tp),* most of which are income and property taxes. Generally speaking, disposable income can be used in one of two ways. Recipients can either consume (C) or save (S) their income. This idea will be very important later when we look at consumer spending in more detail.

DI = PI – Tp or C + S

The five national-income accounts are distinctive measures of income that are useful in different contexts. GNP measures *gross* income; NNP measures *net* income; *NI* measures income *earned; PI* measures income *received;* and *DI* measures *disposable* income received. For some general purposes, it does not make a great deal of difference which of the five income measures are used in discussing a nation's output. In other instances, such as consideration of the income available to households, it makes a great difference. For that reason, it is important to remember the composition of these income accounts.

Prices: Money Income versus Real Income

GNP is the sum of all *physical* outputs multiplied by their prices. Since GNP = output × prices, an increase in income may reflect increased physical output, increased prices, or a combination of both rising output and rising prices. Let us suppose that the prices of goods and services increased by 25 per cent between 2005 and 2015. Any dollar measure of GNP estimated in 2015 would also rise by 25 per cent even though the physical output remained constant because the dollar 'yardstick' used is variable. A 25 per cent increase in GNP due to rising prices does not leave a society better off. Thus, it is appropriate to correct income measures for changes in the price level.

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Computing a Price Index: What does it mean if the Consumer Price Index is, say, 100 in 1958, or 136 in 1971? An index value of 136 means that in 1971, the general level of consumer prices was 36 per cent more than what it was in 1958. An index of 100 for the arbitrarily selected base year 1958 simply means that in that year ₹1 = ₹1. An index value of 90 means that the prices are 10 per cent less than what they were in 1958, the base year. The construction of a price index proceeds as follows:

1. Some period of time is selected as a base period, a period when prices are regarded as being 100 per cent; each ₹1 is equal to ₹1 in purchasing power. The base year selected could be any year, although the average price level for 1957–1959 is presently used.

   $$\text{CPI} = \frac{\text{Price of basket 1957-1959}}{\text{Price of basket 1957-1959}} \times 100 = 100 \text{ for the base period}$$

   Suppose a basket of typical consumer purchases sold for ₹40 in 1957–1959 and ₹60 in 1975. The Consumer Price Index for 1975 would then be calculated as follows:

   $$\text{CPI} = \frac{\text{Price of basket 1975}}{\text{Price of basket 1957-1959}} \text{ or } \frac{₹60}{₹60} \times 100 = 150$$

   Apparently, prices increased by 50 per cent over this period. In other words, the purchasing power or value during the period 1957–1959 declined because it takes ₹1.50 to buy what ₹1 purchased earlier. The base period for a price index can be changed to another year, such as 1975. Then, the price index for 1957–1959 is calculated in the following manner:

   $$\text{CPI} = \frac{₹40 \text{ (1957-1959)}}{₹60 \text{ (1975)}} \times 100 = 66.7$$

   This figure simply shows that the same bundle of goods that costs $1 in 1975 could be purchased for 67 cents in 1957–1959. It really does not matter what year is used as a base, since a price rise from 67 cents to $1 also represents a 50 per cent increase in prices (one-half of 67 cents is 33 cents, the sum being $1).

Adjusting Money to Real Income: In order to correct money GNP, wages, or any other current-dollar measure for price increases or decreases, simply divide money income for each year by the appropriate price index for that year:

$$\text{Real GNP} = \frac{\text{Money GNP}}{\text{Price Index}}$$

Shortcomings to National-Income Accounting

There are many difficulties in measuring a nation's income. Some of the more important shortcomings encountered are described as follows:

- ***Quality:*** Income accounts like Gross National Product or personal income represent the current market value of output. They do not normally reflect

NOTES

changes in the quality of output—or of life in general, for that matter. Advances in medical care, transportation, frozen foods and no-iron clothing are a few of the many contemporary changes in the quality of output not reflected by GNP. Improvements in the quality of goods over the years imply that levels of living may exceed the dollar magnitudes represented by GNP. At the same time, GNP does not reflect the debasement of the environment due to smog or water pollution which reduces the quality of life.

- ***Leisure***: Gross National Product is deficient as a measure of economic welfare also because it ignores increased leisure time. Certainly, the movement from a 55- to a 40-hour workweek since the early 1900s denotes an increase in economic welfare, even though it is not reflected by income measures.
- ***Output Distribution and Composition***: It is difficult to determine the extent to which a nation is better off simply because its Gross National Product has increased. Both the distribution and the composition of increased output must be considered. Increases in GNP due to more weapons output may represent a deterioration in economic welfare rather than an improvement. If additional income is distributed to the wealthy but not to the poor, its implications for economic welfare again are unclear.
- ***Non-market Measurement Failures:*** Gross National Product excludes some output not passing through the marketplace. The classic example of output not included in GNP is the housewife's output, highly productive though she may be. Academic research is similarly not included in the GNP (questions of productivity aside). The treatment given to output produced or in process and not yet sold is still another problem area. Usually, inventories are valued as if sold, whereas goods in process are valued at their cost to the firm. There are still other instances, as when a handyman paints his home, production and consumption occur but are not included in the GNP.
- ***Social versus Private Market Values:*** Income accounts are deficient technically in that they measure only the private market value of output. It is possible that market values may differ substantially from social and psychic values. There are no unambiguous ways to measure social values; still many would agree that private market values may overstate the value of such output as liquor, drugs or tobacco, at least in those instances in which they lead to disease, crime or death. Income estimates privately valued are not adjusted for polluted air or junkyards adjacent to otherwise attractive areas, all of which may have important social value. The real paradox, however, is that as GNP grows and pollution increases, GNP increases even more. This is because the economy produces pollution-abatement equipment to overcome the effects of the initial growth in output.

In short, there are many hazards in trying to discern the value of economic output, although these limitations can be minimized if measurement criteria are applied consistently. Even though there are shortcomings to national-income accounting, measures of Gross National Product, Net National Product, National Income, Personal Income, and Disposable Income are useful and reasonably accurate.

We have seen that GNP refers to the aggregate financial worth of the output that is produced within a country in a given year, plus the income earned by its citizens (including income of those located abroad), minus income of non-residents located in that country. GNP is a measure of the total value of goods and services that all the citizens of a country produce regardless of where they are located. GNP is considered to be an important measure of the financial state of a country's economy, assuming that an increase in GNP has inevitable leads to a better quality of living.

Per Capita Income

Per capita income or average income or income per person refers to the mean income of a population within an economic aggregate, such as a country or a city. We can calculate per capita income by adding all sources of income in the aggregate (such as GDP or Gross National Income), and dividing this sum by the total amount of population. Per capita income does not indicate the way the income or wealth has been distributed in an economy.

Per capita income as a measure of prosperity

Usually, per capita income is used to ascertain the income of the population of a nation, specifically in relation to other nations. This income is denoted using an accepted standard of international currency such as the Euro or United States dollar. It is a commonly known standard used widely and is computed using the easily-available GDP and population estimates. As mentioned earlier, it is a widely accepted standard that can be used to compare the prosperity of a nation against another.

The limitations of per capita income being used as the only indicator of economic progress are as follows:

- Since we derive a mean value by calculating per capita income, we do not get any information about wealth distribution in the economy. When the wealth of a country has been distributed unevenly in such a way that it tilts towards the rich, the per capita also rises. Therefore, the mean income is a better indicator of affluence or prosperity than per capita income because it is less affected by the outliers (an extreme deviation from the mean).
- Per capita also excludes those economic activities that do not generate economic gains, such as services provided within the family or for barter.

NOTES

The significance of such activities differs extensively among different economies.

- When comparing the per capita income of two nations over time, we need to take into account any changes in prices. Without using measures of income adjusted for inflation, we will get overstated figures of economic growth.
- The comparisons of per capita income among different countries can be misrepresented by the variations in the costs of living between countries that are not indicated in exchange rates.

Physical Quality of Life Index

While it is clear that economic growth has benefited mankind, equality and quality in life are by no means assured by growth in aggregate income. Both the distribution of and the growth in a nation's income are at the focal point of the environmental-quality problem. As US President Nixon has said, 'At the heart of this concern for the environment lies our concern for the human condition: for the welfare of man himself, now and in the future.'

There are two basic dimensions to the quality of life and the environment—the individual and the aggregate. First, if individual incomes are unequal, individual shares of whatever quality of life a socio-economic system and the natural environment provide, are also unequal. Because of the preferential way a society distributes its output to its citizens, the quality of life is vastly different for millions of people, particularly those at the lower and the uppermost extremes. Thus, environmental quality and the 'human condition' must be viewed at the personal level.

The total environment is also an important economic problem for society today, as anyone who has experienced air and water pollution will recognize. The quality of man's environment in this broader context is conditioned by a growth in GNP, which overstates how much better or worse off a nation is, as output rises. This overstatement is due to the fact that the production of more output of 'goods' also entails the creation of pollutants or 'bads,' as Professor Kenneth Boulding once chided. 'Bads' assume a variety of overt and subtle forms such as physical pollution of the air and water and urban congestion and blight. The quality of life, then, is the joint product of the personal distribution of income and the aggregate level of deterioration of the general environment.

The Physical Quality of Life Index (PQLI) is a method of measuring the quality of life or economic welfare of a nation. It can be measured by arriving at the mean of three elements: basic literacy rate, infant mortality and life expectancy at age one, all equally weighted on a scale of zero to hundred. This index was established for the Overseas Development Council in the mid-1970s by Morris David Morris, to replace GNP as a benchmark of a nation's development. PQLI is better than GNP as an indicator of development, but it suffers from several

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problems regarding the measurement of quality of life quantitatively. As infant mortality and life expectancy are overlapping categories, so, PQLI cannot be considered as an adequate indicator of development.

Steps to Calculate Physical Quality of Life

1. Ascertain the percentage of the literate population (literacy rate).
2. Find the infant mortality rate. (out of 1000 births) INDEXED Infant Mortality Rate = (166 - infant mortality) × 0.625
3. Find the Life Expectancy. INDEXED Life Expectancy = (Life expectancy - 42) × 2.7
4. Physical Quality of Life =

$$\frac{\text{Literacy Rate + INDEXED Infant Mortality Rate + INDEXED Life Expectancy}}{3}$$

Human Development Index

Economic development measured by per capita income fails to account some social and economic factors; some of these factors include standard of living, life expectancy, literacy and inequalities in the distribution of income, etc. Hence, another measure known as the Human Development Index number has been developed. This index number combines the economic growth and social welfare.

The Human Development Index (HDI) is a compound statistic of life expectancy, education, and income indices, which is used to position and classify nations into four grades or levels of human development. It was developed by the famous Pakistani economist Mahbub ul Haq, followed by Noble laureate Amartya Sen in 1990, and publicized by the United Nations Development Programme.

The index appeared for the first time in the Annual Development Reports of the United Nations Development Programme (UNDP). The definite objective of the Index was to 'shift the focus of development economics from national income accounting to people centered policies'. The Pakistani economist, Mahbub ul Haq, was responsible for bringing together world famous economists such as Paul Streeten, Frances Stewart, Gustav Ranis, Keith Griffin, Sudhir Anand and Meghnad Desai in order to develop the Human Development Reports. They were chiefly aided by Amartya Sen who worked on abilities and operations that provided the fundamental theoretical framework. Haq was of the opinion that there was a need for a simple composite measure of human development that could help scholars and makers of policies to valuate development based not only on economic well-being, but other measures also that denoted overall human well-being. Initially, Sen was sceptical towards this approach, but he ended up helping Haq in developing the index. Sen pointed towards the complexity of subjecting the human potential in a single index, but Haq convinced him that they could capture the

attention of policy makers by presenting a single index that could help them look beyond economic progress as a benchmark of development.

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The following are the four most important elements that characterize human development:

1. **Productivity:** People should be empowered to make such choices that boost their productivity and engage them entirely in the generation of income and gainful employment.
2. **Equity:** Everybody should have equal access to all kinds of opportunities. The obstacles that characterize financial and political opportunities should be phased out to effectuate equal participation and benefits accruing to these opportunities.
3. **Sustainability:** Opportunities should be made available not only to the present generations, but also to the posterity. Better opportunities would provide equal or better opportunities for future generations.
4. **Empowerment:** The participation of people in decisions related to their lives paves the path for actual development. The marginalized sections of the society cannot be excluded from decisions that impact their lives. This can only be taken care of by enabling their participation in all matters concerning them.

New method for 2011 data onwards

According to the Human Development Report, the HDI comprises of the following three dimensions:

- A long and healthy life: Life expectancy at birth
- Education index: Mean years of schooling and Expected years of schooling
- A decent standard of living: GNI per capita (PPP US$)

In its 2010 Human Development Report, the UNDP adopted a more novel approach, and started using another method of computing the HDI. The following three indices were used:

1. Life Expectancy Index (LEI)= $\frac{\text{LE-20}}{\text{82.3-20}}$

2. Education Index (EI) = $\frac{\sqrt{\text{MYSI} - \text{EYSI}}}{0.951}$

2.1 Mean Years of Schooling Index (MYSI) = $\frac{\text{MYS}}{13.2}$

2.2 Expected Years of Schooling Index (EYSI) = $\frac{\text{EYS}}{20.6}$

3. Income Index (II)= $\frac{\ln(\text{GNIpc}) - \ln(100)}{\ln(107721) - \ln(100)}$

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Finally, the HDI is the geometric mean of the previous three normalized indices:
HDI = $\sqrt[3]{\text{LEI} \cdot \text{EI} \cdot \text{II}}$

Where,

LE : Life expectancy at birth

MYS : Mean years of schooling (Years that a 25-year-old person or older has spent in schools)

EYS : Expected years of schooling (Years that a 5-year-old child will spend with his education in his whole life)

GNIpc : Gross national income at purchasing power parity per capita

Old method used until 2011

The following are the three measures of HDI up until its 2011 report:

- Life expectancy at birth, as an index of population health and longevity
- Knowledge and education, as measured by the adult literacy rate (with two-thirds weighting) and the combined primary, secondary, and tertiary gross enrolment ratio (with one-third weighting).
- Standard of living, as indicated by the natural logarithm of gross domestic product per capita at purchasing power parity.

The formula defining the HDI is promulgated by the United Nations Development Programme (UNDP) In general, to transform a raw variable, say *x*, into a unit-free index between 0 and 1 (which allows different indices to be added together), the following formula is used:

$$x - \text{index} = \frac{x - \min(x)}{\max(x) - \min(x)}$$

Where min(*x*) and max (x) are the lowest and highest values the variable *x* can attain, respectively.

The Human Development Index (HDI) then represents the uniformly weighted sum with one-third contributed by each of the following factor indices:

$$\text{Life Expectancy Index} = \frac{\text{LE}-25}{85-25}$$

$$\text{Education Index} = \frac{2}{3} \times \text{ALI} + \frac{1}{3} \times \text{GEI}$$

$$\text{Adult Literacy Index (ALI)} = \frac{\text{ALR}-0}{100-0}$$

$$\text{Gross Enrolment Index (GEI)} = \frac{\text{CGER} - 0}{100-0}$$

$$\text{GDP} = \frac{\log(\text{GDPpc}) - \log(100)}{\log(40000) - \log(100)}$$

Other organizations/companies may include Democracy Index, Population, etc. which produces different number of HDI.

1.4 CAUSES OF UNDER DEVELOPMENT

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Underdevelopment means having a low level of economic productivity and technological sophistication within the contemporary range of possibility. The term 'development' is generally used to mean industrialization, economic growth and the living standards associated with prosperity, such as increased life expectancy, health-care and free education. The countries that have not yet achieved these objectives are said to be 'undeveloped' countries.

Disparity between the rich and the poor and an unhealthy balance of trade are the characteristics of an underdeveloped country. The trade and commerce balance is often skewed as the products these countries yield for export such as bananas, coffee, sugar, cocoa, tea are not in great demand in the developed countries. The products that demand a smaller quantity of raw materials such as jute, cotton, etc., are being substituted by synthetic materials. Prices of organic and natural raw materials cannot be increased as this leads to an industrial clamouring for the synthetic products. On the other hand, production can also not be increased as this again brings down the prices. Thus, the developing countries face this elusive development as the primary commodities used by them are subject to short-term price inflation.

Different criteria of underdevelopment

Countries are categorized as underdeveloped on the basis of the following criteria:

- **Low ratio of industrial output to total output:** Countries with a low ratio of industrial output to total output are considered underdeveloped.
- **Low ratio of capital to per head of population:** According to Ragnar Nurkse, 'Underdeveloped countries are those, which compared with the advanced countries, are under-equipped with capital in relation to their population and natural resources.'
- **Poverty:** Poverty is one of the main criteria of underdevelopment. Poverty is nothing but lack of basic standards of living. The people of underdeveloped countries are characterized by less money or salary, less education, improper health care, sanitation, etc.
- **Low per capita income:** Most acceptable criterion of underdevelopment is low per capital real income.

Characteristics of Less Developed Countries

The characteristics of underdevelopment may be summarized as follows:

- **General poverty:** Most of the people in underdeveloped countries are poor, leading a wretched life without any norms of standard of living. Poverty results in low labour productivity, lack of entrepreneurship and poor specialization.

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- **Agriculture, the main occupation:** An underdeveloped economy depends largely on the production of agricultural materials and minerals. Industries in such countries are mainly agro-based. The share of the primary sector, which includes the agriculture and allied activities, is larger in the national income of the underdeveloped country.
- **A dualistic economy:** An underdeveloped economy is characterized by the presence of dualistic economy— the existence of both market economy and subsistence economy at the same time. There is a market economy on one side, where marketing system has developed exceedingly well, and caters to the needs of rich and wealthy class of people. On the other hand, there is subsistence economy which is characterized by backward agriculture-oriented activities in rural areas.
- **Underdevelopment of national resources:** The natural resources of the underdeveloped economy are either unutilized or underutilized. For example, India is a country of vast natural resources which has not been fully utilized.
- **Demographic features:** Another feature of underdeveloped countries is that they are invariably overpopulated. The size of the population in these countries is increasing at a faster rate than in developed countries.
- **Unemployment and disguised unemployment:** Excessive pressures on land and poor industrial development create unemployment problems in underdeveloped countries. The problem of unemployment has resulted in underemployment. Owing to population pressure, more persons work on land than what is actually required. This is referred to as disguised unemployment.
- **Economic backwardness:** The people of underdeveloped countries are economically backward. The economic backwardness is characterized by lower efficiency, illiteracy, poverty, factor-immobility, lack of entrepreneurship and ignorance in economic matters.
- **Lack of enterprise and initiative:** An important characteristic of underdeveloped countries is the lack of entrepreneurship and initiative. The governments of underdeveloped countries are not very encouraging towards entrepreneurship. The people of such countries are largely risk averse. They generally prefer a long-term employment such as government jobs.
- **Insufficient capital equipment:** Capital has a strategic role in the production and economic development of a nation. The insufficient amount of physical capital in existence is also a characteristic feature of underdeveloped economies. Hence, they are often called simply 'capital poor' economies. One indication of the capital deficiency is the low amount of capital per head of population.
- **Technological backwardness:** In underdeveloped countries, the methods of production are primitive. As a result, the productivity in agriculture or in

industries is very low. The lack of technical know-how and poor scientific advancement and obsolete technique result in poor quality products.

- **Foreign trade orientation:** Underdeveloped countries are usually foreign trade-oriented. They export raw materials instead of utilizing them at home and import manufactured goods instead of making them at home. Excessive dependence on export makes these countries precarious and unbalanced, affecting their terms of trade adversely.

Prevalence of underdevelopment

(i) **Africa:** Africa consists of one-seventh of the world's population. It is the second largest continent with fifty-four countries and 800 million people. It accounts for twenty per cent of the planet. This is the most underdeveloped continent. The continent had faced 400 years of slavery which has ultimately resulted in ethnic and political fragmentation. Political and social unrest has caused economic instability that has left communities unfit for pursuing economic development.

(ii) **Afghanistan:** Afghanistan's underdevelopment has resulted from ineffective trade policies with little economic growth. Thirty-five per cent of the population is unemployed. Pervasive military and political corruption has left the economy of the country shattered and the culture and religion broken. Disruption of trade and commerce has resulted in the falling of GDP every year. Internal conflicts have left the country incapable of reviving with domestic and international aids.

(iii) **Latin America:** Latin America consists of the South American nations where people primarily speak Spanish, Portuguese and French. The infant mortality rate here is very high and the life expectancy of people are twenty years lesser than those of people in developed countries. Unemployment, homelessness and malnourishment have become rampant in this part of the world with many communities being poverty-stricken. The region has suffered due to over population, military dictatorships and wars. It is replete with cases where larger countries have oppressed its smaller neighbours. The free trade policies adopted in the nineteenth century prevented the development of national industries in the region.

(iv) **South Africa:** South Africa is a segregated land of the rich and the poor. The rich are integrating the country with global economy and adopting industrialization, agricultural and financial services. The second economy is the economy of the underprivileged. South African countries nurture institutionalized apartheid that influences politics, society and economics. Reforms have further increased the chasm between the rich and the poor through uneven distribution of wealth. As Hoogeveen and Ozler (2005: 15) conclude in their paper 'Not Separate, Not Equal: Poverty and Inequality in Post-Apartheid South Africa' that 'growth has not been pro-poor in South Africa as a whole, and in the instances when poverty declined for certain

subgroups, the distributional shifts were still not pro-poor'. The economy is dictated by those who are incorporated in the mainstream and not by those living under unfavourable circumstances.

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Check Your Progress

3. List four types of expenditures that comprise GNP.
4. What is the Physical Quality of Life Index (PQLI)?
5. Who developed the concept of human development index?
6. State two characteristics of underdeveloped countries.

1.5 ANSWERS TO 'CHECK YOUR PROGRESS' QUESTIONS

1. There are two common measures of the rate of economic growth. The first is the rate of growth of a nation's real Gross Domestic Product and the second is the rate of growth of per capita real Gross Domestic Product.
2. The two causes for low rate of capital formation are:

   Low rate of savings

   Equal distribution of income
3. The four main types of expenditures that comprise GNP are consumption (C), gross investment (I), government purchases of goods and services (G) and net exports (Ex).
4. The Physical Quality of Life Index (PQLI) is a method of measuring the quality of life or economic welfare of a nation. It can be measured by arriving at the mean of three elements: basic literacy rate, infant mortality and life expectancy at age one, all equally weighted on a scale of zero to hundred.
5. The concept of Human Development Index was developed by the famous economist Mahbub ul Haq.
6. Underdeveloped countries are characterised by overpopulation and technological backwardness.

1.6 SUMMARY

- There are two common measures of the rate of economic growth. The first is the rate of growth of a nation's real Gross Domestic Product and the second is the rate of growth of per capita real Gross Domestic Product.
- In order to represent the process of economic growth, it is convenient to use the production possibilities curve which shows all efficient combinations of output that an economy can produce.

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- The production possibilities curve shows all efficient combinations of output that an economy can produce.
- The analysis of economic growth is concerned mainly with measuring of growth in economic variables, and identifying their interrelationships such as between the national income growth rate and the speed of capital formation.
- The concept of economic growth is much narrower than the concept of economic development.
- Economic growth involves a steady increase in any or all elements that constitute GDP, namely, consumption, investment, government expenditures and net exports.
- Economic development involves an increase in the Human Capital Index, a notable decline in social and economic inequality, and structural changes that contribute to a basic improvement in the overall quality of a nation's population.
- Economic growth pertains to an increase in the output of an economy, whereas economic development pertains to structural changes that take place in an economy.
- A major problem with economic growth is not taking into account the exhaustion of natural resources that may cause pollution, congestion and the occurrence of various diseases. The concept of development, on the other hand, is synonymous with sustainability referring to meeting present needs without having to compromise the future needs.
- The broadest measure of a nation's total income is the Gross National Product (GNP)—a measure of the market value of all final output produced over a period of time.
- In the expenditure context, GNP is made up largely of household consumption expenditures, business investment expenditures, and government purchases of goods and services.
- In the context of income payments, GNP is the sum of wages, salaries and profits earned by human resources; rent and interest payments to property resources; and two types of non-income payments—the value of capital resources used up or 'consumed' in production, and indirect business taxes.
- An accurate measurement of GNP demands that the value of goods and services produced is measured only once, and not a number of times as goods pass through various stages of production.
- GNP can be estimated by summing either of the income payments to all resources of expenditures for final output. Either way, we are measuring only the current final market value of goods and services produced.

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- The four main types of expenditures that comprise GNP are consumption (C), gross investment (I), government purchases of goods and services (G) and net exports (Ex).
- The five income accounts commonly used to measure economic activity are GNP, NNP, National Income, Personal Income and Disposable Income.
- GNP is considered to be an important measure of the financial state of a country's economy, assuming that an increase in GNP has inevitable led to a better quality of living, other variables remaining unaffected.
- Per capita income or average income or income per person refers to the mean income of a population within an economic aggregate, such as a country or city.
- The Physical Quality of Life Index (PQLI) is a method of measuring the quality of life or economic welfare of a nation. It can be measured by arriving at the mean of three elements: basic literacy rate, infant mortality and life expectancy at age one, all equally weighted on a scale of zero to hundred.
- The Human Development Index (HDI) is a compound statistic of life expectancy, education, and income indices which is used to position and classify nations into four grades or levels of human development.
- Underdevelopment means having a low level of economic productivity and technological sophistication within the contemporary range of possibility. Disparity between the rich and the poor and an unhealthy balance of trade are the characteristics of an underdeveloped country.
- Most of the people in underdeveloped countries are poor, leading a wretched life without any norms of standard of living. Poverty results in low labour productivity, lack of entrepreneurship and poor specialization.
- Excessive pressures on land and poor industrial development create unemployment problems in underdeveloped countries. The problem of unemployment has resulted in underemployment. Owing to population pressure, more persons work on land than what is actually required.

1.7 KEY WORDS

- **Gross Domestic Product:** The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis
- **Production possibility curve:** It is a hypothetical representation of the amount of two different goods that can be obtained by shifting resources from the production of one, to the production of the other
- **GNP:** GNP stands for Gross National Product. It means an economic statistic that includes GDP, plus any income earned by residents from overseas

investments, minus income earned within the domestic economy by overseas residents.

- **Human Capital Index:** It measures how well an organization makes use of the ability of an individual to perform and create shareholder value through his/her competencies, knowledge and expertise.

1.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What do you understand by economic development?
2. How do the production possibilities curves help us in charting out the economic growth of a nation?
3. What do the shifts in the production possibilities curve indicate? What does it mean when there is no shift on the curve?
4. How does the concept of value addition influence the accuracy of GNP?
5. Define per capita income. Why do we use it?
6. Write a short note on the Human Development Index.
7. How are countries categorised as underdeveloped?

Long Answer Questions

1. Critically analyse the concept of economic growth.
2. Enumerate the difference between economic growth and economic development.
3. Discuss the chief shortcomings of considering GNP as the sole indicator of the economic health of a nation.
4. Discuss five income accounts as a measure of a nation's economic activity in detail.
5. Explain in detail the characteristics of less developed countries.

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UNIT 2 DEVELOPMENT AND THE NEW ECONOMIC POLICY

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Structure

2.0 INTRODUCTION

In this unit, you will learn about development gap and the indicators of development. Gender Empowerment Measure (GEM) and Gender-related Development Index (GDI) are some examples of quality of life indicators. Further in the unit, the discussion will move towards the concept of the New Economic Policy and its introduction in India. After the adoption of the new economic policy in India, the country has reviewed its policies and made it friendlier in almost all the sectors. The unit will also delve into the objectives of New Economic Policy.

2.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain how to measure development and development gap
- Examine the concepts of human development index and relative and absolute poverty
- Discuss the objectives of New Economic Policy

2.2 DEVELOPMENT

The economic position of every country in the world is not similar. Some geographical areas are more developed than others. In common parlance, the world economies are categorized into MDCs (More Developed Countries) and LDCs (Less Developed Countries). This classification of countries is easy to understand. Many other terms are also used by economists to categorize the countries. The less developed countries are called Third World Countries and

developed countries are addressed as First World Counties. Under First World Countries, the industrial economies or capitalist countries are found. It includes Japan, United States, Western Europe and Australia. Asia, Africa and Latin American countries are known as Third World Countries. Communist countries like Eastern Europe, China, Soviet Union, North Korea, Cuba and Vietnam are known as Second World Countries. But with the collapse of communism, the term Second World Countries is not very popular. This three-model classification has now become outdated. Now another category of Fourth World Countries is also found. Under this, those countries are counted that are very poor, tribal and are of a nomadic setup. These countries may be self-sufficient and surviving on their own but on economic parameters or indicators, these are far behind the rest of the world. Countries like Russia are known as centrally planned countries.

On the basis of economic growth and development, various international and regional countries are known with different names. For example, India and China are known as NIC (New Industrialized Countries). While the UAE is known as Oil Exporting Countries, US, UK, Japan and Australia are known as rich industrialized countries. Recent financial and economic crisis has raised several questions on the performance of many advanced and developed countries. Therefore, a country can never be in same state. It is always on the basis of several indicators of economic growth that one can judge where it lies. As you have already learnt in Unit 1. The economic development of a country can be measured through various indicators. These indicators are known as measures of development. Broadly these indicators are classified into:

- Economic indicators
- Technology and industry related indicators
- Social and welfare related indicators
- Others

You have studied some of these indicators in detail in Unit 1. Let's briefly summarize them.

1. **Gross Domestic Product (GDP):** It measures the total value of all goods produced in a country during a year. It is a prime indicator to understand the development stage or the health of a country. It can be calculated either on the basis of total spending of the each person or on the basis of total income earned in a year by each one in a country. It is the total of investment by consumers, spending by government and net exports (export minus import):

   GDP = consumption + investment + (government spending) + (exports – imports)

2. **Gross National Product (GNP):** It is the total value of goods and services produced by nationals of a country by using labour resources and investment on domestic land and foreign land in a year. In case of GDP, goods produced

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within the boundary of a country are considered while in case of GNP, the goods and services produced by the nationals of a country on a foreign land are also considered.

GNP = GDP + NR (Net income inflow from assets abroad or Net Income Receipts) – NP (Net payment outflow to foreign assets)

3. **Gross National Income (GNI) Per Capita:** It measures the income received by a country from national and overseas income. It is similar to Gross National Product.
4. **Per Capita Consumption:** It measures the average consumption per person in a country. It is calculated on the basis of market value of all goods and services purchased by households of a country and then divided by the average population of that country. Generally more advanced countries have more urban population.
5. **Infrastructure:** Infrastructure is always a foundation of a country. It includes:
   - Energy distribution
   - Transport networks
   - Communication networks, access to ICT
   - Urban centres
   - Basic facilities like schools, hospitals, postal services
   - Farms and factories
   - Mines
   - Police and armed forces
6. **Human Development Index (HDI):** The HDI is computed by United Nations Development Program (UNDP) for each country every year. The Human Development Index is composed of three indicators:
   - Life expectancy
   - Education (adult literacy and combined secondary and tertiary school enrolment), and
   - Real GDP per capita
7. **Population Growth:** Population growth rate is a major indicator of social welfare. Some economies have lesser population growth rate of one or two per cent while others have higher growth rate. It directly affects the quality of life in an economy. The ‘Rule of 70’ says that if population growth rate remains one percent, then in seventy years it will be doubled. A small change in population growth rate may lead to a significant change in total population of a country.
8. **Urbanization:** It measures the percentage of total population of a country living in urban areas.

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9. **Social indicators:** Literacy rate, infant mortality, life expectancy, and caloric intake are several standard parameters to measure the social welfare state of an economy.
10. **Occupational structure:** It is also needed to measure that what proportion of the working population is employed in primary, secondary and tertiary sector. It determines their quality of life, consumption pattern and income as well.
11. **State of political stability:** Political corruption, democratic government and civil war are also significant to measure the state of development of an economy.

A single indicator should not be considered to measure the development of an economy. It is always a blend of several parameters through which the development state of an economy can be assessed.

There is another point of view which says that it is equally important to understand the development gap of an economy to measure development. The term development gap means the gap among the rich and poor countries of the world. At a narrow level, it can also be the gap between rich and poor people of a country or the gap in development between urban and rural people. That is why the notions like rich/poor countries, North/South Region, Developed/Developing /Underdeveloped countries, First world/Second World/Third World, and LEDC/ MEDC/NIC are in existence. Even to measure the development gap the indicators discussed above are considered but a further analysis is required to see how much population of the country is using how much resources. Or what is the gap between the income, consumption and quality of life of richest and poorest people of a country. The development gap can be seen on the basis of following parameters.

- Economic indicators like GDP, GNP, GNI, etc.
- Gender divide
- Composite indices like HDI, international suffering index, physical quality of life index
- Digital Access Index (DAI) which measures the access to ICT
- Social indicators measuring health, education, safety and housing, etc.

Alternative measures of development

The dislike of per capita GDP as an indicator gave rise to a broad based definition of economic development and indicators of development. It was found that PC GDP can be a measure to improve the life of the people at large.

1. Physical Quality of Life Index (PQLI)

You have studied in Unit 1 that this index was developed by Morris D. Morris in 1979. According to him, income is only an input in the process of economic development and not the output in itself. Moreover, it also does not explain how

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the income is distributed in the society. He takes into consideration three broad indicators that help in explaining the quality of life of the people. These are literacy rate, life expectancy and the infant mortality rate. These three parameters help in understanding the changes in the basic life of the people during the process of economic development. Equal weight is assigned to each variable. The maximum and minimum values are measured on a scale of zero to ten. The countries are then ranked as per the actual achievements in these three components. For instance, the minimum value of literacy rate is zero and the maximum is 100. Similarly, the lowest life expectancy was thirty-nine years in Somalia and seventy-six in Canada. Similarly, the infant mortality rate was the highest in Bangladesh at 139 per thousand and the lowest in Denmark at eight per thousand. Infant mortality rate is a negative index and hence the country with the lowest IMR will be ranked higher compared to the country with higher IMR. The averages of the three give PQLI, the Physical Quality of Life Index.

2. Inequality of Income

The inequality of income means unequal distribution of income among individual household of a country. It measures the disparity of income between the individual making most of the money and least of the money. The inequality of income is a relative measure to study the gap between household incomes of a region or a country.

Increasing income inequality is a universal phenomenon. The inequality of income and wealth has increased as a result of increasing globalization. The examples of income inequality can be seen in the form of rising corporate profits but decline in income of employees, higher income of males than females, higher income of urban people in comparison of rural people, and higher income of developed economies in comparison to developing and underdeveloped economies, etc.

Majority of the countries of the world are facing the situation of income inequality. Whether we take the example of US, India, China or other countries, the recent trends of income inequality have shown that the gap between rich and poor has increased.

The two measures used to commute the income inequality are Lorenz curve and Gini Index.

The Lorenz curve explains the percentage of income earned by a percentage of population. A perfect income distribution will have a Lorenz curve, i.e., a straight line showing same percentage change in income caused by same percentage change in population.

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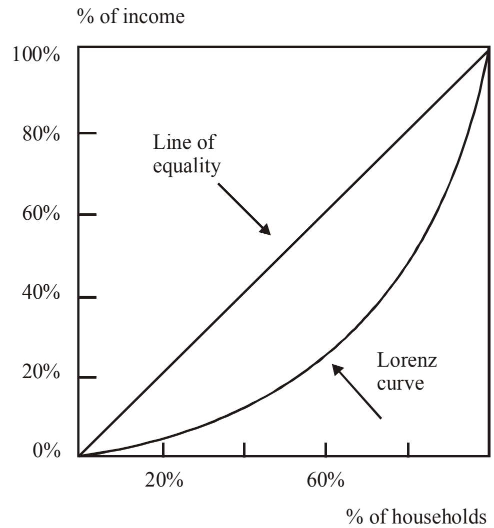
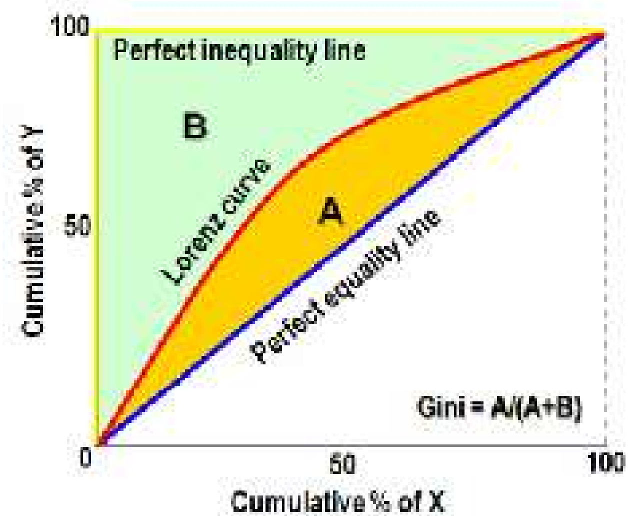


Figure 2.1 A Lorenz Curve Illustrates Inequality

The Gini coefficient is also used to measure the inequality of income. The Gini coefficient calculates the deviation of income distribution in a country from a perfect equity income state in that country. If Gini coefficient is zero, it indicates the perfect equality and if it is one, it shows perfect inequality of income, indicating that a single person is holding the whole income. The inequality in income is an indicator of social welfare of the country. The increasing income inequality increases the social unrest.



3. Human Development Index

The Tenth Plan Report of the Government of India had wisely noted that, Economic growth cannot be the only objective for national planning and indeed over the years, development objectives are being defined not just in terms of increases in GDP or per capita income but more broader in terms of enhancement of human

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well being. This includes not only an adequate level of consumption of food and other types of consumer goods but also access to basic social services especially education, health, availability of drinking water and basic sanitation. It also includes the expansion of economic and social opportunities for all individuals and groups, reduction in disparities, and greater participation in decision making.

Amartya Sen, the Nobel Laureate and one of the pioneers of the concept of human development, mentions:

> The basic purpose of development is to enlarge people's choices. In principle, these choices can be infinite and can change over time. People often value achievements that do not show up at all, or not immediately, in income or growth figures: greater access to knowledge, better nutrition and health services, more secure livelihoods, security against crime and physical violence, satisfying leisure hours, political and cultural freedoms and a sense of participation in community activities. The objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives.

Development should be all encompassing, all nourishing and all pervading. Development objectives need to be defined not just in terms of increases in GDP or per capita income but in broader terms of the enhancement of human well-being.

UNDP also mentions that human development is a process of expanding people's choices in life. These choices can be infinite and can change over time. However, the three basic capabilities that are universally applicable are the capability to live a long and healthy life, capability to be knowledgeable and capability to acquire a decent standard of living. If these essential choices are not available, many other opportunities will remain inaccessible. HDI, therefore, incorporates only these three variables (UNDP 1994).

In view of the new dimension of the concept of human development, UNDP formulated the Human Development Index (HDI). You have already studied in Unit 1 that HDI is a summary measure of human development that measures the average achievement in a country in three basic dimensions of human development:

- A long and healthy life, as measured by life expectancy at birth (LEB).
- Knowledge, as measured by the adult literacy rate (with two-thirds weight) and combined primary, secondary, and tertiary gross enrolment rate.
- A decent standard of living as measured by GDP per capita (PPP US$).

For each of these three dimensions, an EDEP (equally distributed equivalent percentage) is calculated and HDI is calculated as a simple average of the three indexed EDEPs as shown in the Table 2.1.

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Table 2.1 Calculation of HDI

Index	Measure	Minimum Value	Maximum Value	Formula
Longevity (L)	LEB	25 years	85 years	$\text{LEB/LEI}=\frac{\text{Actual–Min}}{\text{Max-Minn}}$
Education (E)	Literacy Rate (LR)	0 %	100 %	
	Combined Gross Enrollment Ratio (CGER)	0 %	100 %	
GDP	GDP per capita (PPP)	100 US$	40000 US$	$\text{GDPI}=\frac{\text{logactual–logmin}}{\text{Logmax–logmin}}$

In case of literacy rate, 2/3 weight is assigned to Adult Literacy Rate and 1/3 weight is assigned to combined Gross enrolment ratio. Equal weight is given to all three variables viz., life expectancy, literacy rate and PPP PC GDP. HDI is then calculated as follows:

HDI= 1/3LEI+1/3 CGER +1/3 GDPI.

The value of HDI would lie between zero and one. Higher value of HDI will indicate the achievement level of a country.

Criticism

The Human Development Index has been criticized on a number of grounds, including failure to include any ecological considerations, focusing exclusively on national performance and ranking, and not paying much attention to development from a global perspective. Other authors claimed that the Human Development Reports 'have lost touch with their original vision and the index fails to capture the essence of the world it seeks to portray'. The index has also been criticized as 'redundant' and a 'reinvention of the wheel', measuring aspects of development that have already been exhaustively studied. The index has further been criticized for having an inappropriate treatment of income, lacking year-to-year comparability, and assessing development differently in different groups of countries.

Economist Bryan Caplan, has criticized the inclusion of schooling in HDI with argument that 'a country of immortals with infinite per-capita GDP would get a score of .666 (lower than South Africa and Tajikistan) if its population were illiterate and never went to school.'

Some economists discuss the HDI from the perspective of data error in the underlying health, education and income statistics used to construct the HDI. They identify three sources of data error which are due to (i) data updating, (ii) formula revisions and (iii) thresholds to classify a country's development status, and find that eleven per cent, twenty-one per cent and thirty-four per cent of all countries

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can be interpreted as currently misclassified in the development bins due to the three sources of data error respectively. The authors suggest that the United Nations should discontinue the practice of classifying countries into development bins because the cut-off values seem arbitrary; it can provide incentives for strategic behaviour in reporting official statistics and have the potential to misguide politicians, investors, charity donators and the public at large which use the HDI.

As mentioned in Unit 1, in 2010, the UNDP reacted to the criticism and updated the thresholds to classify nations as low, medium and high human development countries. In a comment to *The Economist* in early January 2011, the Human Development Report Office responded that they undertook a systematic revision of the methods used for the calculation of the HDI and that the new methodology directly addresses the critique in that it generates a system for continuous updating of the human development categories whenever formula or data revisions take place.

However, each year, UN member states have been ranked according to the computed HDI. If high, the rank in the list can be easily used as a means of national aggrandizement; alternatively, if low, it can be used to highlight national insufficiencies. Using the HDI as an absolute index of social welfare, some authors have used panel HDI data to measure the impact of economic policies on quality of life.

Ratan Lal Basu criticizes the HDI concept from a completely different angle. According to him, the Amartya Sen-Mahbub ul Haq concept of HDI considers that provision of material amenities alone would bring about human development, but Basu opines that human development in the true sense should embrace both material and moral development. According to him, human development based on HDI alone is similar to dairy farm economics to improve dairy farm output. To quote: 'So human development effort should not end up in amelioration of material deprivations alone: it must undertake to bring about spiritual and moral development to assist the biped to become truly human.' For example, a high suicide note would bring the index down.

A few authors have proposed alternative indices to address some of the index's shortcomings. However, of those proposed alternatives to the HDI, few have produced alternatives covering many countries. No development index (other than, perhaps, Gross Domestic Product per capita) has been used so extensively or effectively in discussions and developmental planning as the HDI.

4. Gender Development Index and Gender Empowerment Measure

Two global gender indices, namely the Gender Related Development Index (GDI) and Gender Empowerment Measure (GEM), were introduced in the Human Development Report 1995. GDI was also measured with the help of life expectancy, education and income, but it was measured after adjusting the HDI for gender inequality. The greater the gender disparity in basic human development, the lower would be a country's GDI compared to HDI.

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GEM shows whether women are actively involved in political and economic field. It focuses on political participation, economic participation and power over economic resources.

Three drawbacks of GDI and GEM, as pointed out by some critics, are as follows:

1. The measures combine absolute and relative achievements. Thus, a country with low absolute income scores poorly even with perfect gender equity. The GDI adjusts the HDI for gender inequalities, thereby measuring both total achievements and disparities. However, it is often misinterpreted as reflecting only disparities.
2. Nearly all indicators in the GEM reflect a strong urban elite bias and use of some indicators which are more relevant to developed countries.
3. Extensive imputations were needed to fill in missing data. For the relative income share in both indices, more than three-fourths of a country's estimates were partly imputed. With income as the most important driver of the wedge between the HDI and the GDI, this imputation was particularly problematic.

Gender Inequality Index (GII)

HDR 2010 introduced a new measure named Gender Inequality Index (GII) in order to address the above criticisms. GII does not rely on imputations. It includes three critical dimensions for women: reproductive health, empowerment and economic activities or participation in labour market.

According to the Human Development 2019, India ranks 144 out of 187 countries on the Gender Inequality Index. Among BRICS (Brazil, Russia, India, China, South Africa) nations, India has the highest inequalities in human development.

Poverty: Absolute and Relative

Poverty is a multifaceted occurrence which is caused by various factors. There are different ways of defining poverty. The most common of these are objective and subjective poverty. Poverty can also be defined as absolute and relative on the basis of scale of threshold. Another popular way of defining poverty is static and dynamic. The dynamic studies focus on the length of duration of poverty.

Absolute poverty is a state in which the basic needs of an individual are not covered. These basic needs include the needs which are related to food, housing and clothes. This is a widely accepted method of defining poverty across the world. But the problem with this method is that sometimes it is difficult to measure absolute poverty. Relative poverty is defined in a different context. It means that the individual is at a disadvantageous position (financially or socially) in comparison to other individuals in the same environment. The relative measure of poverty is used to describe the inequality in distribution of income. The criteria of measuring

relative poverty cannot be same for all the countries. A person who is relatively poor in America may not be poor in India. Moreover, there cannot be a static way of defining poverty over a period of time. It is a dynamic subject and it keeps on changing with passage of time.

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Different poverty lines are drawn to measure absolute and relative poverty. The absolute poverty lines are based on some absolute standard. It is a monetary threshold used to meet the basic needs. The relative poverty lines are based on overall distribution of income and overall consumption in a country. The absolute measure of poverty is considered as a better approach. Further, there are different approaches to measure absolute poverty. Generally, it is measured on the basis of either food-energy intake method or the cost of basic needs method. You will learn about the measurement of poverty in further units. It is important to know here that poverty is intimately related to development. The level of poverty is indicative of how developed the country is and that is why its study is very important.

Check Your Progress

1. Name some of the First World countries.
2. Which type of countries fall under the category of Fourth World countries and why?
3. Which parameters help determine development gap?
4. What are the three basic dimensions of human development?
5. What is the Lorenz curve used for?

2.3 NEW ECONOMIC POLICY

The New Economic Policy or the New Industrial Policy was brought in the year 1991 for giving an impetus to economic development in the country. Under the New Industrial Policy, in the past almost three decades, the industries have been freed to a large extent from the licenses and other controls. In order to encourage modernization, stress has been laid upon the use of latest technology. A great reduction has been effectuated in the role of the public sector.

Efforts have been made to encourage foreign investment. Investment decision by companies has been facilitated by ending restrictions imposed by the erstwhile MRTP Act. Similarly, Foreign Exchange Regulation Act (FERA) has been replaced with Foreign Exchange Management Act (FEMA).

1. New Industrial Policy

Some important points of the New Industrial Policy have been highlighted here:

(a) **Abolition of Licensing:** Before the advent of the New Industrial Policy, the Indian industries were operating under strict licensing system. Now, most industries have been freed from licensing and other restrictions.

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(b) **Freedom to Import Technology:** The use of latest technology has been given prominence in the New Industrial Policy. Therefore, foreign technological collaboration has been allowed.

(c) **Contraction of Public Sector:** A policy of not expanding unprofitable industrial units in the public sector has been adopted. Apart from this, the government is following the course of disinvestment in such public sector undertaking. (Selling some shares of public sector enterprises to private sector entrepreneurs is called disinvestment. This is a medium of privatisation.)

(d) **Free Entry of Foreign Investment:** Many steps were taken to attract foreign investment. Some of these are as follows:

- In 1991, fifty-one per cent of foreign investment in thirty-four high priority industries was allowed without seeking government permission.
- Non-Resident Indians (NRIs) were allowed to invest 100% in the export houses, hospitals, hotels, etc.
- Foreign Investment Promotion Board (FIPB) was established with a view to speedily clear foreign investment proposals.
- Restrictions which were previously in operation to regulate dividends repatriation by the foreign investors have been removed. They can now take dividends to their native countries.

(e) **MRTP Restrictions Removed:** Monopolies and Restrictive Trade Practices Act has been done away with. Now the companies do not need to seek government permission to issue shares, extend their area of operation and establish a new unit.

(f) **FERA Restrictions Removed:** Foreign Exchange Regulation Act (FERA) has been replaced by Foreign Exchange Management Act (FEMA). It regulates the foreign transactions. These transactions have now become simpler.

(g) **Increase in the Importance of Small Industries:** Efforts have been made to give importance to small industries in the economic development of the country.

2. New Trade Policy

Trade policy means the policy through which the foreign trade is controlled and regulated. As a result of liberalisation, trade policy has undergone tremendous changes. Especially, the foreign trade has been freed from the unnecessary controls.

The age-old restrictions have been eliminated at one go. Some of the chief characteristics of the New Trade Policy are as follows:

(i) **Reduction in Restrictions of Export-Import:** Restrictions on the exports-imports have almost disappeared, leaving only a few items.

(ii) **Reduction in Export-Import Tax:** Export-import tax on some items has been completely abolished and on some other items it has been reduced to the minimum level.

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(iii) Easy Procedure of Export-Import: Import-export procedure has been simplified.

(iv) Establishment of Foreign Capital Market: Foreign capital market has been established for sale and purchase of foreign exchange in the open market.

(v) Full Convertibility on Current Account: In 1994-95, full convertibility became applicable on current account. Here, it is important to clarify the meaning of current account and full convertibility. Therefore, this has been done as follows:

- **Current Account:** Transactions with the foreign countries are placed in two categories: (i) transaction with current account such as import-export, (ii) Capital account transactions such as investment.
- **Full Convertibility:** In short, full convertibility means unrestricted sale and purchase of foreign exchange in the foreign exchange market for the purpose of payments and receipts on the items connected with current account. It means that there is no government restriction on the sale and purchase of foreign exchange connected with current account.

  On the other hand, sale and purchase of foreign exchange connected with capital account can be carried on under the rates determined by the Reserve Bank of India (RBI).

3. Fiscal Reforms

The policy of the government connected with the income and expenditure is called fiscal policy. The greatest problem confronting the Indian government is excessive fiscal deficit. In 1990-91, the fiscal deficit was eight per cent of the GDP. (It is important to understand the meaning of fiscal deficit and GDP.)

(i) Fiscal Deficit: A fiscal deficit means that the country is spending more than its income.

(ii) Gross Domestic Product (GDP): The GDP is the sum total of the financial value of all the produced goods and services during a year in a country. Generally, the financial deficit is calculated in the form of GDP's percentage. Presently, the government of India is making efforts to take it to four per cent.

Solutions of Fiscal Deficit

In order to handle the problem of fiscal deficit, basic changes were made in the tax system. The following are the major steps taken in this direction:

- The rate of the individual and corporate tax has been reduced in order to bring more people in the tax net.
- Tax procedure has been simplified.
- Heavy reduction in the import duties has been implemented.

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4. Monetary Reforms

Monetary policy is a sort of control policy through which the central bank controls the supply of money with a view to achieving the objectives of the general economic policy. Reforms in this policy are called monetary reforms. The major points with regard to the monetary reforms are given below:

- Statutory Liquidity Ratio (SLR) has been lowered. (A commercial bank has to maintain a definite percentage of liquid funds in relation to its net demand and time liabilities. This is called SLR. In liquid funds, cash investment in permitted securities and balance in current account with nationalised banks are included.)
- The banks have been given the freedom to decide the rate of interest on the amount deposited.
- New standards have been laid down for the income recognition for the banks. By recognition of income, we mean what is to be considered as the income of the bank. For example, whether directions have been issued to consider bad debt as income of the bank.
- Permission to collect money by issuing shares in the capital market has been granted to nationalised banks.
- Permission to open banks in the private sector has also been granted.

5. Capital Market Reforms

The market in which securities are sold and bought is known as the capital market. The reforms connected with it are known as capital market reforms. This market is the pivot of the economy of a country. The government has taken the following steps for the development of this market:

- Under the Portfolio Investment Scheme, the limit for investment by the NRIs and foreign companies in the shares and debentures of the Indian companies has been raised. (Portfolio Investment Scheme means investing in securities.)
- In order to control the capital market, the Securities and Exchange Board of India (SEBI) has been established.
- The restriction in respect of interest on debentures has been lifted. Now, it is decided on the basis of demand and supply.
- The office of the Controller of Capital Issue which used to determine the price of shares to be issued has been dispensed with. Now, the companies are free to determine the price of the shares.
- Private sector has been permitted to establish Mutual Fund.
- The registration of the sub broker has been made mandatory.

6. Phasing out Subsidies

Cash Compensatory Support (CCS) which was earlier given as export subsidy has been stopped. CCS can be understood with the help of an example.

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If an exporter wants to import some raw material which is available abroad for 100, but the same material is available in India for 120 and the governments wants the raw material to be purchased by the exporter from India itself for the protection of indigenous industries, the government is ready to pay the difference of 20 to the exporter in the form of subsidy. The payment of 20 will be considered as CCS. In addition to this, the CCS has been reduced in case of fertilizers and petro products.

7. Dismantling Price Control

The government has taken steps to remove price control in the case of several products. (Price Control means that the companies will sell goods at the prices determined by the government.) The efforts to remove price control were mostly in respect of fertilizers, steel and iron and petro products. Restrictions on the import of these products have also been removed.

2.3.1 Objectives of NEP

Economic Reforms in India were started by Prime Minister Rajiv Gandhi. He said, 'the public sector has entered into too many areas where it should not be. We shall open the economy to the private sector in several areas hitherto restricted to it.' Consequently, a number of measures were taken to remove control open areas to private sector players. However, Rajiv Gandhi did not take a very strong and categorical position on the issue of privatization and globalization, though some liberalization of the economy did take place. It was when Mr. Narasimha Rao took over as Prime Minister in 1991 that a new industrial policy was announced which marked a sharp departure from the earlier industrial policy of 1956.

There were three aims of the *New Economic Policy*—Liberalization, Globalization and Privatization.

Initiatives Taken under NEP

In 1991, as you have already learnt in the previous section, the government took a series of initiatives in respect of the policies relating to the following areas:

(i) Industrial Licensing

(ii) Foreign Investment and Technology Agreements

(iii) Public Sector Policy

(iv) MRTP Act

A package for the small and tiny sectors of industry was announced separately. Let's briefly recapitulate the important points under the NEP 1991, before discussing its evaluation.

1. **Industrial Licensing Policy:** Industrial licensing will henceforth be abolished for all industries, except eighteen sectors which need regulation because of security and strategic concerns, social reasons, chemical hazards, environmental protection and curbing elitist consumption. Among these

industries are cars, sugar, cigarettes, colour TV and VCRs, white goods like air conditioners, refrigerators and electronic washing machines.

All registration schemes including Director General of Technical Development are to be abolished; entrepreneurs have to only file an information memorandum on new projects and expansions.

Eight areas, where strategic and security concerns predominate, continue to be reserved for public sector.

Attaining exemption from licenses will especially aid many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. On the whole, the Indian economy will benefit if it becomes more competitive, efficient and modern.

No industrial approvals will be required for putting up plants in locations other than cities with a population of more than one million. Where the population is more than one million, industries (with the exception of electronics, computer software and printing) will have to set up units outside a 25-km radius, except in prior designated industrial areas.

As per the industrial policy statement, the mandatory convertibility clause will no longer be applicable for term loans from financial institutions for new projects put by large houses.

With the sweeping liberalization measures, the existing procedures have been streamlined accordingly. All existing registration schemes have been abolished.

2. **Foreign Investment and Technology Agreements:** While liberalizing the Indian industry from the control and domination of the government, opportunities for promotion of investments should also be fully explored. Foreign investment would bring its associated advantages of marketing expertise, technology transfer, introduction of modern managerial techniques and new possibilities for promotion of exports. This is especially important in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment, which is in the interest of the country's industrial development. These include commercial vehicles and two wheelers, inorganic fertilizers, chemicals, man-made fibres, drugs and pharmaceuticals, paper, tyres, Portland cement, hotels, many food-processing industries, soya products and industrial and agricultural machinery. There shall be no bottlenecks of any kind in this process. This change will go a long way in making Indian policy on foreign investment transparent. Such a framework will make it attractive for companies abroad to invest in India.

   A special empowered board is to be set up to negotiate with large international firms for direct investment in select areas. The aim is to attract substantial investment that would provide access to high technology and world markets.

NOTES

To attain the desired technological dynamism in the Indian industry, the government will provide default approval, subject to certain conditions for technology agreements for high-priority industries within specified areas. Other industries will be provided with similar provisions as well, if such agreements do not require spending of free foreign exchange. Indian companies will be free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial opinions.

3. **Public Sector Policy:** Public sector enterprises have been central to the development philosophy. Public ownership and control in critical sectors of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good.

   The Industrial Policy Resolution, 1956, gave the public sector a strategic role in the economy. Substantial investments have been made over the past five decades to build the public sector. Recently, several issues have cropped up in many of the public enterprises. In addition, these enterprises have shown a very low rate of return on the capital invested. Many of the public enterprises have become a burden to the government. This category of public sector units accounts for almost one-third of their total losses.

   It is time that the government undertook new measures to develop public enterprises. The key areas for the growth of public enterprises will be as follows:

   (i) Vital infrastructure goods and services
   (ii) Exploitation and exploration of oil and mineral resources
   (iii) Development of technology and building of manufacturing capabilities in areas crucial for the long-term development of the economy and where private sector investment is inadequate
   (iv) Manufacturing products where strategic considerations predominate such as defence equipment. At the same time, the public sector will not be prevented from entering areas not specifically reserved for it.

   The government will strengthen those public enterprises that come under reserved areas or are generating good profits. Such enterprises will be provided much greater managerial autonomy through memorandums of understanding. Competition can be introduced by encouraging private sector participation. In the case of selected enterprises, part of government holdings in these enterprises will be disinvested to discipline the performance of public enterprises. There are a large number of chronically sick public enterprises that are incurring heavy losses and serve little purpose. These need to be tended to.

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New Public Sector Policy: The low rate of return on capital invested reduced the ability of the public enterprise to regenerate themselves in terms of new investments as well as in new technology developments. This resulted in many of the public enterprises becoming a burden rather than an asset to the government. The new Industrial Policy of 1991 has redefined the role of the public sector. Public sector will be in future restricted to essential infrastructure, goods and services, exploration of oil and mineral resources and manufacture of products, where strategic considerations predominate such as defence equipment.

The number of industries reserved for the public sector have been reduced to eight. The scrapping of the schedule B which contained a list of twelve industries, where public sector was to play a dominant role, is also an important policy change.

The government is thinking of throwing open to the private sector most of the industries reserved for the public sector. In other words, monopoly in any sector has to be abolished.

4. **MRTP Act:** The principal objectives sought to be achieved through the MRTP Act are as follows:
   (i) Prevention of concentration of economic power to the common detriment.
   (ii) Control of monopolies
   (iii) Prohibition of monopolistic and restrictive and unfair trade practices

The need to achieve economies of scale and the growing complexity of industrial structure ensure higher productivity and competitive advantages in the international market. The MRTP Act's role in investment decisions of large companies has become deleterious in its effects on Indian industrial growth. The scrutiny of investment decisions by so-called MRTP companies will no longer be needed. The provisions relating to mergers, acquisitions, amalgamations and takeovers will also be repealed. Similarly, the provisions regarding restrictions on acquisition and transfer of shares will be appropriately incorporated in the Companies Act.

Hence, the government has decided to take adequate measures to liberalize the Indian industrial economy from the tangle of unrequired bureaucratic control.

Evaluation: Captains of industry and apex trade bodies have welcomed the new industrial policy, particularly the decisions to do away with licensing for most industries, liberalization of foreign investment and lifting the threshold limit for MRTP. The new industrial policy is a major step in ushering the country into a new era of development and progress. The new policy will change the structure of Indian industry. It is directed towards making Indian industry internationally competitive. According to the FICCI president, many retrograde restrictions have been either removed or amended and conditions have been created for a market-friendly

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system, which will enable India to join the international mainstream on the basis of efficiency and competitiveness. The president of the Associated Chamber of Commerce and Industry described the policy as a landmark in the opening up of the Indian economy and complemented the government for replacing the command and controlled economy which has been replaced all over the world with competitive and market economy.

The new policy is pragmatic, bold, innovative, and growth-oriented and the onus now lies with the industry to take advantages of these changes and rise to the occasion before demanding further liberalization.

On the other hand, the new industrial policy comes in for some sharp criticism by opposition leaders all over the country. The general reaction was that the policy was a sell out to the IMF and the World Bank and hit the common man. Former Prime Minister Chandrashekhar assailed the new policy and described it as a total drift from the Gandhian path. He feared the policy would generate more unemployment. Former Finance Minister Madhu Dandavate said that by abolishing the limits on MRTP companies, the government had put the small-scale sector in a tight corner. This would seriously affect employment potential and poverty alleviation.

Check Your Progress

6. State any two steps that the government has taken in capital market reform.
7. Write any two steps taken by the government to liberalize industrial policy.

2.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Under First World Countries, the industrial economies or capitalist countries are found. It includes Japan, United States, Western Europe, and Australia.
2. The category of Fourth World Countries include those countries are counted that are very poor, tribal and of a nomadic setup. These countries may be self-sufficient and surviving on their own but on economic parameters or indicators, they are far behind the rest of the world.
3. The development gap can be seen on the basis of following parameters:
   - Economic indicators like, GDP, GNP, GNI, etc.
   - Gender divide
   - Composite indices like HDI, international suffering index, physical quality of life index
   - Digital Access Index (DAI) which measures the access to ICT
   - Social indicators measuring health, education, safety and housing, etc.

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4. Three basic dimensions of human development are:
   - A long and healthy life, as measured by life expectancy at birth (LEB).
   - Knowledge, as measured by the adult literacy rate (with two-thirds weight) and combined primary, secondary, and tertiary gross enrolment rate.
   - A decent standard of living as measured by GDP per capita (PPP US$).
5. The Lorenz curve explains the percentage of income earned by a percentage of population. A perfect income distribution will have a Lorenz curve, i.e., a straight line showing same percentage change in income caused by same percentage change in population.
6. The government has taken the following steps for the development of this market:
   - Under the Portfolio Investment Scheme, the limit for investment by the NRIs and foreign companies in the shares and debentures of the Indian companies has been raised. (Portfolio Investment Scheme means investing in securities.)
   - In order to control the capital market, the Securities and Exchange Board of India (SEBI) has been established.
7. The two steps taken among others to liberalize industrial policy are:
   - Abolition of Licensing
   - Freedom to Import Technology

2.5 SUMMARY

- The economic position of whole world is not uniform. Some geographical areas are more developed than others. In common parlance, the world economies are categorized into MDCs (More Developed Countries) and LDCs (Less Developed Countries).
- The term development gap means the gap among the rich and poor countries of the world. At a narrow level, it can also be the gap between rich and poor people of a country or the gap in development between urban and rural people.
- The inequality of income means unequal distribution of income among individual household of a country. It measures the disparity of income between individual making most of the money and least of the money. The inequality of income is a relative measure to study the gap between household incomes of a region or country etc.
- The dislike of per capita GDP as an indicator gave rise to a broad based definition of economic development and indicators of development. It was found that PC GDP can be a measure to improve the life of the people at

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large. Various indicators were developed during this period. One such indicator was the Physical Quality of Life Index (PQLI).

- In view of the new dimension of the concept of human development, UNDP formulated the Human Development Index (HDI). HDI is a summary measure of human development on the basis of certain indicators.
- The Human Development Index has been criticized on a number of grounds, including failure to include any ecological considerations, focusing exclusively on national performance and ranking, not paying much attention to development from a global perspective and based on grounds of measurement error of the underlying statistics and formula changes by the UNDP which can lead to severe misclassifications of countries in the categories of being a 'low', 'medium', 'high' or 'very high' human development country.
- Poverty is a multifaceted occurrence which is caused by various factors. There are different ways of defining the poverty. The most common of these are objective and subjective poverty. Poverty can also be defined as absolute and relative on the basis of scale of threshold. Another popular way of defining poverty is static and dynamic. The dynamic studies focus on the length of duration of poverty.
- Under the New Industrial Policy, the industries have been freed to a large extent from the licenses and other controls. In order to encourage modernization, stress has been laid upon the use of latest technology. A great reduction has been effected in the role of the public sector.
- In the New Economic policy, efforts have been made to encourage foreign investment. Investment decision by companies has been facilitated by ending restrictions imposed by the MRTP Act. Similarly, Foreign Exchange Regulation Act (FERA) has been replaced with Foreign Exchange Management Act (FEMA).

2.6 KEY WORDS

- **Fiscal Deficit:** A fiscal deficit means that the country is spending more than its income.
- **Development gap:** The term development gap means the gap among the rich and poor countries of the world. At a narrow level, it can also be the gap between rich and poor people of a country or the gap in development between urban and rural people.
- **Relative poverty:** Relative poverty is defined in a different context. It means that the individual is at a disadvantageous position (may be financially or socially) in comparison to other individuals in the same environment. A person who is relatively poor in America may not be poor in India.
- **Capital market:** The market in which securities are sold and bought is known as the capital market

2.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. How have countries traditionally been classified as per their economic positions?
2. What is the state of absolute poverty?
3. Outline the steps to calculate the physical quality of life.
4. What is the Gender Development Index and where does India stand as per this index?

Long-Answer Questions

1. Explain the following indicators of development: GDP, GNP, GNI, Per capita consumption, Infrastructure and HDI.
2. Discuss the concept of inequality of income in detail. Also include the Lorenz curve and Gini index in your explanation.
3. Examine the concept of Human Development Index, including the criticism it garnered.
4. Explain in detail the New Economic Policy.

2.8 FURTHER READINGS

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UNIT 3 DEVELOPMENT AND ENVIRONMENT

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Structure

3.0 INTRODUCTION

In this unit you will study about the consequences of the development process on the environment. Development activities affect the environment in various ways; development results in pollution (air, water, and soil), deforestation, desertification, loss of biodiversity, etc. As a result of centuries of rampant human activity, environmental and ecological degradation has reached such proportions that human survival is threatened today. The aspect of the consequences of development on environment is equally important and needs attention. The unit will discuss this aspect in detail.

3.1 OBJECTIVES

After going through this unit, you will be able to:

- Assess the consequences of development on Ecology and Environment
- Discuss ecological concerns of development projects

3.2 CONSEQUENCES OF DEVELOPMENT ON ECOLOGY AND ENVIRONMENT

The human developmental process has affected our environment and ecology in a variety of ways. Development had led to pollution (air, water, and soil), deforestation, desertification, loss of biodiversity, etc. Let's now look at some of these consequences of human development in detail.

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Environmental pollution

Environmental pollution refers to the process through which different kinds of human activities make natural resources harmful by adding pollutants like harmful gases, chemicals, industrial and human waste. The development of human civilisation has been based on the exploitation of natural resources like air, water and soil. These natural resources are renewable meaning they have a mechanism through which the polluted part becomes fresh after a given period. As a result of the renewability property of these resources, limited growth does not cause permanent harm to the environment. However, as a result of massive industrialisation, urbanisation and population growth, the level of pollutants have become so high that the process of renewability has decreased. As a result, all these resources have gradually become polluted. Today, many of these resources have become harmful and are causing a wide array of diseases. For example, air pollution is caused by the burning of coal, oil and other conventional energy resources. The burning of these fuels leads to the production of carbon dioxide, carbon monoxide, sulphur, etc., which is extremely harmful to both humans and the environment alike. The production of chlorofluorocarbons (CFCs) causes the depletion of the Ozone Layer of the atmosphere. The depletion of the Ozone Layer and production of other greenhouse gases also cause a rise in the atmospheric temperature, skin related diseases and so on. The most terrible effect of air pollution is acid rain which is caused by the overproduction of sulphur and other chemicals in the air. Likewise, water pollution is caused by various means. The dumping of harmful industrial and domestic waste in the sea or rivers makes the water useless for human beings. It also kills life in the water bodies such as fish and living species. Soil pollution is caused by the overuse of fertilisers and chemicals to increase production. Moreover, over-exploitation of soil makes it infertile as natural production of humus takes time.

Global Warming

Global Warming means the gradual rise of world temperature. Scientists have proved that this rise of the global temperature is directly related due to the massive production of greenhouse gases. The Global temperature has gone up by half degree Celsius in the sixty years that have passed since 1950. The reasons for the massive production of these greenhouse gases are population increase, urbanisation, industrialisation and motorised transportation. Some effects of global warming are hot winters and even hotter summers, disproportionate rainfall and the rise in the sea levels due to the melting of ice in the Antarctic. According to scientific projections, if current level of production of these greenhouse gases continue then it is expected that the world temperature could be three to six degrees higher than average current temperature by the year 2100. This will have a disastrous effect on human society and result in huge displacement of people, natural disasters like unseasonable floods, droughts, snowfalls, and so on. As a result of a rise in temperature, agricultural patterns will change, diseases will increase and entire

ecosystems will vanish. We are already witnessing the effects of climate change throughout the world. Among the nine hottest years ever recorded in human history since 1866, seven occurred in less than ten years starting from 1987 to 1997. The latter was the hottest year of the last century (Ibid).

This process of global warming is reversible when all of mankind makes a joint effort. Voluntary and compulsory restraints on the use of natural common resources like air, water, forest and soil should be applied and those who exploit them beyond their prescribed limits should be made to pay for it. Technological innovations can also be used to refine industrial and other pollutants and reduce their harmful effects. The use of alternative renewable energy resources like solar energy, wind energy, nuclear energy, etc. can also reduce the level of toxic and greenhouse gases in the atmosphere. Educating the masses about the bad effects of their ignorant use of natural resources is another way of protecting the environment. Controlling population growth can also reduce the burden on common resources in the long run. However, perhaps the best way of reversing global warming is to end human reliance on non-renewable fossil fuels as a source of energy. Coal and natural oil are the largest energy sources. Their burning in industries and transportation produces the largest amount of greenhouse gases.

Deforestation

Deforestation is another consequence of the development of human civilisation. Most of the agricultural lands and lands for other human settlements have been converted from what used to be forests earlier. This process is still continuing. According to environmental scientists, ecological balance can only be maintained if one third of the land is covered by forests. These forests help in cleaning the atmosphere, bringing rain and housing a large number of species that help in maintaining the ecological balance. The world's rainforests, found in Latin America, Africa, India and other Asian countries are believed to have the largest biodiversity pool in the world. These forests are being destroyed gradually for various purposes like creating additional lands for agriculture, human habitation, industries, wood timber, paper industries, and so on. It has been estimated that due to different development projects, around 52 acres of world's forests were lost every minute in the 1990s (Ibid: 333). According to another estimate, around 200 million hectares of forests have been destroyed every year even after the 2000s. If the current pace is maintained, in the next 40 years we will have no forests left on the earth (Haynes Jeffery, 2008: 142). Another statistics by the FAO (UN), 'State of World Forests (2020)', 'Between 2015 and 2020, the rate of deforestation was estimated at 10 million hectares per year, down from 16 million hectares per year in the 1990s. The area of primary forest worldwide has decreased by over 80 million hectares since 1990.' The destruction of these forests causes the loss of livelihood for the local communities. On the broader level, it causes soil erosion, flash floods and desertification, and ultimately leads to climate change. Deforestation is the main cause of landslides in the mountain areas. The topography of the mountain

regions requires trees and plants to hold on to the soil. If there are no trees or plants any small earthquake or vibration can cause massive landslides in the mountains.

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The loss of forests has led to the loss of global flora and fauna. Forests of different kinds have been home to a large number of species. There are still several among them which are unknown to us. The importance of biodiversity for the environment is that they are crucial for the maintenance of the ecosystem. All the species are related to a chain and the loss of any one from this chain can cause massive disruption in the natural environment. It has been argued that present day deserts had been green forests in the past. They became deserts because of the loss of vital species from the local chain of ecosystems. In other words, the loss of even one species can cause disruption of ecosystem and loss of natural environment. The effect of increasing human activities and massive deforestation is that some of the species are vanishing gradually from the earth. The tropical rainforests are home to two thirds to three fourths of all species in the world. Their destruction can cause a massive crisis for the natural environment. Moreover, the pollution of rivers, sea and air also pose danger to the species living in these ecosystems. The massive hunting of whales for food and other medicinal uses has created possibilities of their extinction as well. Their extinction can cause the loss of life cycle inside the ocean. Similarly, man's use of certain fertilisers and chemicals to kill certain pests which destroy crops has caused the death of numerous species of earth worms and butterflies. These species are important links to soil fertility and the spread of natural vegetation. Their extinction can cause infertility and the loss of local natural vegetation.

Enclosure movements undertaken by the Multi-National Corporations (MNCs) to claim the ownership of common property resources like certain kinds of species (for example Neem and turmeric trees from Global South) and seed through patent rights is another challenge to biodiversity in poor countries. The attempts to produce and use genetically modified (GM) seeds or hybrid seeds are also no different. These so called high productive seeds can cause the loss of natural biodiversity and create dangers for local economies. The GM seeds can also cause loss of all those species of seeds which have a natural resistance power to local climate and ecology. There have been attempts to curb this planned loot of natural resources by the world community particularly on the insistence of the Global South. In 1992, the Earth Summit, a Global Convention of Biodiversity, was held. According to its guidelines which is accepted by most of the world, national governments were advised to take steps to preserve biodiversity. In India, several attempts have been taken before and since the Earth Summit in 1992 to preserve biodiversity. Some of these are the formation of National Parks, Reserved Forests and Biodiversity Parks in different parts of India. India has undertaken various conservation projects to preserve important species like tigers, elephants and other small endangered animals and plants.

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Desertification

Desertification is a process through which arable land is claimed by sand or natural vegetation is lost through manmade or natural causes. Mindless exploitation of arable land can cause loss of fertility resulting in the desertification of land. Some of the most important reasons of desertification are massive irrigation projects which cause the deposition of silt in the fields. The increased grazing that results from commercial use of the animals is one of the main reasons for the loss of natural vegetation. All these intensive uses of agricultural land and natural resources are happening in most parts of the world due to a massive rise of population and increased consumption. For example, ground water resources are being over exploited for intensive farming in some parts of Punjab and Western UP in India. These areas are prone to desertification. Desertification can cause famine and hunger particularly in poor countries. According to the UNEP, more than 1.2 billion hectares of land have been converted into deserts due to human practices. Some of the traditional farming practices like shifting cultivation of land such as *Jhoom* farming in India, have also been blamed for the desertification of agricultural land. However, it should be noted that these practices have a limited impact. The real reason of desertification at the macro level is intensive farming and animal herding practices. These measures of farming have become inevitable in the last century as world consumption has increased. Although it is impossible to halt the mechanisation of agriculture, we have to devise ways to check the desertification of the existing agricultural land.

The impact of globalisation and free market led growth has caused tremendous damage to the natural environment around the world, particularly in the Global South. The pressure on the already overburdened ecology is the result of high consumption patterns in the North and population growth in the South. Poverty and hunger are increasing and it is often the poor who suffer the most when any ecological imbalance occurs. Despite the fact that the world is producing more than double the quantity of food it used to produce in the 1950s, millions of people still go hungry every day. Widespread poverty and hunger cannot be addressed without using natural resources. This makes scientific and technological advancement in production compulsory. Poor and uneducated people sometimes overexploit natural resources out of desperation and ignorance. Until poverty is addressed, no attempt to preserve nature will be successful. It is useless to blame the poor for the destruction of the natural resources. The need of the hour is to educate the world about the need for sustainable development and its relations with population control. Governments should also be more vigilant in checking the misuse of natural resources by the MNCs and even domestic development projects.

Check Your Progress

1. How does the depletion of ozone layer affect the environment?
2. What causes acid rains?
3. What is the impact of using genetically modified (GM) seeds or hybrid seeds on biodiversity?
4. What is desertification?

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3.3 DEVELOPMENT PROJECTS: ECOLOGICAL CONCERNS

In the aftermath of decolonisation, countries in the Global South partook in huge projects of socio-economic development. For a very long period, they were ignorant of the fact that most of these projects were extremely harmful to the environment. However, the need to address poverty and hunger prevalent in these countries forced them to carry on the economic development projects even in the aftermath of revelations of their negative impact on the environment. They argued that there was a need to address the basic needs first and the environment concerns can wait. However, it was soon realised that this strategy will not work in the long run. The pressure created by domestic and global civil society has forced these states to start worrying about environmental issues. Today, civil society and social movements initiate a debate on the environmental impact assessment of any development project before its commencement. Courts, NGOs and the media have forced the government to take notice of the ecological sensitivities before giving permission to any project. However, there are several development projects which cannot address ecological concerns completely and the damage to the environment can only be minimised. After the adoption of neoliberal policies in 1991, private players in India have been found to violate all prescribed environmental norms and cause massive destruction of the natural environment. This section will assess some of the cases from India as well as different parts of the World, which have invited massive mass movements against them due to environmental concerns.

The government of India had initiated Green Revolution in agriculture in late 1960s and 1970s. The main goal of the Green revolution was to make India self-sufficient in the production of the food grains. The Green revolution was based on intensive mechanised farming of land and well planned supply of water through massive dams created on the River Sutlej in Punjab and Haryana (the Bakhara-Nangal project). The supply of hybrid seeds of wheat, massive use of fertilisers and chemicals were sanctioned as acceptable ingredients of the development project. In a few years, production of food grains increased sufficiently and India indeed became self-sufficient. However, it soon became clear that the achievement

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of self-sufficiency was at the cost of environment and the local ecology. Due to the massive use of fertilisers and chemicals, local water bodies in Punjab, Haryana and Western UP became polluted. Canal irrigation left massive tracts of land filled with sand. Due to this, fishermen were unable to fish in the rivers around Sutlej. The Green Revolution also caused massive exploitation of ground water. As a result, a dip in the water level was noticed in several areas of Punjab and Haryana. This has increased fears that the area will become like a desert in the near future. Another major ecological impact of the Green Revolution has been the loss of biodiversity in agriculture as practices of mono cropping increased at the cost of various varieties of crops like millets. Further, the use of pesticides and harmful chemicals was responsible for the extinction of various species of pests and small insects traditionally considered beneficial for the fertility of land. Due to the need of increase in production, new lands from erstwhile arid and semi-arid areas were reclaimed at the cost of local ecology. Again, in some areas of common property, resources like grazing lands and pastures were converted into agricultural land.

Some similar experiments have been done in southern states like Kerala. In order to fulfil the demand for food grains caused by the population increase, the state government has undertaken projects to increase the production of rice. One such project has been undertaken in the Kuttanad region of south central Kerala. Various governments in the state since independence have been promoting land reclamation from the sea in and around Lake Vembanad. This strategy has resulted in various ecological problems like the shrinkage of backwaters, salinity, and the disappearance of several species of fish. The salinity caused by the construction of sea water regulators built on the coasts has reduced the fertilisation of marine shrimps, prawns and other varieties of fish, causing livelihood problems for fishermen as well as ecological imbalances. The project of spillways and regulators on Lake Vembanad aimed to create rice cultivation in the area has resulted in the loss of mangroves on the banks of the lake. Preventing lake water from going back into the sea through regulators has made the water of the lake polluted. Earlier, when the regulator had not been placed, regular tidal waves would refresh the lake water. After the building of the regulator this is not possible and the water in the lake is now filled with the water coming from rice fields. This water is full of pesticides and fertilisers harmful for the ecology of the lake (Narayanan N C, 2008: 96-98).

The construction of large dams on various rivers was initiated during the first plan period in India with twin objectives—irrigation and electricity generation. Today, there are various dams on all the major rivers in India. However, these projects are being questioned by various circles including environmental activists. The construction of a large dam causes three related ecological problems. First, it results in the displacement of a large number of local populations as most of the river valley areas in India are densely populated. According to some estimates, about 30 million people have been displaced in India as a result of dams. Second, it causes the disruption in the natural flow of water and destroys local ecology in the form of the destruction or submergence of farm lands, nearby forests and

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water bodies. Third, it causes conflict between upper and lower riparian population (Shiva Vandana 1991: 203). Large dams cause water logging and salinisation of the land; It is eventually converted into waste lands or deserts. It has been proved that large dams create an imbalance in the ecology of the region. Large dams in the Himalaya like the Tehri Dam on the Ganges will destroy massive forest areas and can cause earthquakes as well.

The Narmada Valley project or the Sardar Sarovar and Narmada Sagar Valley project has been facing stiff resistance from local people who are fighting against their displacement in the streets and also in the highest court of the land. The reasons for fighting against the project are obvious. The Narmada Valley project is a huge project intended to build thirty major, 135 medium and around 3000 small dams at various points of the river. The river is around 1300 km long and flows through three main states—Madhya Pradesh, Maharashtra and Gujarat, before it reaches the Gulf of Cambay in Arabian Sea. The project is aimed to serve three main purposes—provide irrigation to adjacent areas, produce electricity and provide drinking water along with other minor facilities like tourism. It should be noted that most areas of the Narmada Valley and states around it are dry regions. Farming is backward due to an absence of irrigation facilities. The region is dry and therefore potable water is a scarce resource. The projected electricity generation (around 3000 MW) from the project can increase the industrialisation of the region. However, it is also true that dams on Narmada are causing massive displacement of people (around one million), and can also cause salinisation and water logging in the entire area. Siltation in the reservoirs due to soil erosion will reduce the economic use of the dams. Scientists also fear that the salinisation of the upper stream can cause more submergence of the land than it has been estimated. The dams will hamper the flow of river water and it is expected that fish species will be badly affected. The water logging in the dam area may also result in malaria becoming pandemic. The project will also result in a massive loss of biodiversity as forests will be cleared for the construction of dams and for the resettlement of a million people.

The Dumbur hydroelectric project on the River Gumti in Tripura in the 1970s is an example of ecological damage as a result of a development project in the North-East India. The construction of a dam on the river Gumti was a multipurpose project. It was expected that the project would produce around nine megawatts of electricity for local consumption and also control floods in the downstream of the river. The main ecological impact of the project was the displacement of around 3000 families from settled or semi settled habitations. Most of these families moved to *Jhum* farming after their displacement as they had no other livelihood source. Both the construction of the dam and the reinforced *Jhum* farming resulted in the enormous destruction of the forests and the loss of biodiversity in the upper catchment area of the river. The dam submerged around forty-six square kilometres of land. Most of this land was either forest or farms. The creation of roads on the hills (that were already partially uncovered due to loss of natural vegetation) caused

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landslides and soil erosion during rainy seasons. This deforestation, landslides and soil erosion has led to sedimentation of the river beds downstream, causing floods and destroying the river ecology. It has also created sedimentation in the base of the reservoir, making it economically less productive. Though the governments have tried to control *Jhuming* and has also planted trees in the area it has been noticed that the loss of biodiversity cannot be undone (Gupta Malabika Das 1989).

The mining industry is considered a primary industry as it converts natural resources into raw materials for further production of various goods. Mining in India is spread over various states such as Orissa, Jharkhand, West Bengal and Karnataka. Most of the mining industry is based in the tribal areas and extends into the dense forest areas. The establishment of any mining project causes impact on the forest and other natural resources of the region. It causes ecological imbalances like the displacement of the local population, pollution of water and land and so on. Despite strict environmental assessment done by both the state and central governments and installation of modern technologies, pollution in mining cannot be controlled. Open cast mining produces dust and releases toxic chemicals into air and groundwater. Its waste affects nearby agricultural land. The waste ultimately submerges in the sea through rivers and groundwater and due to rain and causes large scale damage to the ecology. This is the story of any mining project in India (Das Smriti and N C Narayanan in Narayanan Ibid: 226-227). In the mining industry, as the recently exposed scams show, environmental norms are often violated due to corruption and absence of proper vigilance. Hence, even if all the environmental norms are adhered to on paper, there is very little chance that it will happen in actuality.

Urbanisation is taking place very fast in India. Today, around twenty-five per cent of the Indian population lives in the cities and towns. City life is supposed to be a sign of development. However, most Indian cities are overcrowded and the majority of the population lives in slums. The expansion of cities is hazardous to the environment as they create huge amount of greenhouse gases and other forms of industrial and domestic waste. Cities like Mumbai produce large amount of polluted water and solid waste, which is often dumped into the sea. This creates dangers for the coastal sea ecology. Hectares of mangroves are destroyed due to dumping of waste. Other cities like Kolkata and Chennai have similar problems. Delhi is situated on the banks of the river Yamuna. The river water is so polluted due to the dumping of industrial and domestic waste into it that it is considered harmful even to touch it. The ecosystem of the river is on the verge of dying. The pollution level of the air around these big and middle size cities in India is very high. It is estimated that these cities are the largest centres of air and water borne diseases in India. Further, the expansion of these cities have destroyed nearby forests. There has been an increase in planned cities in the hilly areas of states like Maharashtra. These 'cities' are sometimes based on the destruction of local ecology.

According to various studies done in the recent years, it has been proved that growth in transportation and communication does have an impact on the

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ecology of the region. The construction of new roads, bridges and highways destroy thousands of acres of forest land all over the world. They result in the loss of plantations as they provide easy human access to new areas. The roads constructed across the forests often lead to the death of several animals. The plants along the highways tend to be exposed to heavy substances like lead and sulphur caused by the burning of fossil fuel in the engines. These substances lead to the slow death of plants and harm the food chains. The emissions of toxic gases, noise pollution and littering caused by the movement of people along the roads and railway tracks can also damage the ecology. Construction of roads and railway lines across the mountains causes soil erosion and landslides. In the cold areas, an increase in traffic creates hot atmosphere due to dust and toxic pollutants like carbon dioxide, lead, sulphur dioxide, etc., resulting in the gradual increase in the temperature. The melting of ice also causes damage to the ice based ecology. The construction of railways, roads and bridges in new areas near to or far from the urban areas create sudden ecological changes which several species cannot adapt to and therefore they become extinct (Spellerberg Ian F, 1998).

One of the best examples of a development project becoming an ecological disaster is the lake called the Aral Sea in the erstwhile Soviet Union in Central Asia. It has been estimated that in the last forty years more than sixty per cent of the Aral Sea has disappeared. Although the government of Kazakhstan has made efforts at trying to save the Aral Sea, it is expected that the Aral Sea will disappear a few years from now. The reason for the disappearance of the Aral Sea was the construction of two dams called Amu Dacrya and Syr Dacrya for irrigation purposes. This irrigation system did increase the production of cotton in the region. However, due to diversion of water from these two rivers, the Aral Sea received less and less water and began shrinking. Before the construction of dams on the rivers, the Aral Sea had a huge fishing industry. In 1982, fishing in the sea for commercial purposes stopped completely. The other effect of the ecological disaster of the Aral Sea is that the livelihood of people nearby is in danger. There have been changes in the local climate as summers have become hotter and winters colder as the lake water has lost its capacity to balance the climate extremities. All the related water bodies in the area are polluted from the fertilisers and chemicals used in the cotton fields. The example of the Aral Sea shows that every 'great' achievement in the development process comes with a price. Sometimes, the price is too heavy if the assessments go wrong.

There are numerous examples of industrial accidents in human history. These industrial accidents sometimes cause massive leaks of harmful gases and chemicals in the environment. In addition to causing deaths of people, these leaks can also harm natural environment and ecology. In April 2010, an oil leak was reported due to offshore oil mining by British Petroleum (BP) in the Gulf of Mexico near the USA. Within a few days, around five million barrels of oil spewed into the sea causing a huge ecological disaster. The Gulf of Mexico is home to different species

of fish. The oil spill has killed most of the species. This accident can create many ecological problems in the future as the fishing industry in the region will not be able to fish for a long time to come. The loss of biodiversity as a result of the oil leak will be permanent in the Gulf. This accident is one of the latest in the series of industrial accidents causing enormous harm to the ecology, the most disastrous being the 1984 Bhopal Gas leak. On December 4, 1984, more than 8000 people died immediately as a poisonous gas called methyl carbonate leaked from the Union Carbide factory in the city. The effects of the leak are still causing various diseases in the local population today. Another horrible example of a development project becoming an ecological hazard is the Chernobyl nuclear accident in Ukraine in 1987. The leakage of radioactive substances from the unit killed many in the area and caused the pollution of local environment leading to acid rains in various parts of Europe.

Check Your Progress

5. Which development project is responsible for the disappearance of the Aral Sea?
6. Name the poisonous gas that caused the 1984 Bhopal Gas Leak Tragedy.

3.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The depletion of the Ozone Layer and the production of other greenhouse gases causes a rise in the atmospheric temperature, skin related diseases and so on.
2. The most terrible effect of air pollution is acid rain which is caused by the overproduction of sulphur and other chemicals in the air
3. These GM seeds can cause the loss of natural biodiversity and create dangers for local economies. The GM seeds can also cause loss of all those species of seeds which have a natural resistance power to local climate and ecology.
4. Desertification is a process through which arable land is claimed by sand and natural vegetation is lost through manmade or natural causes. Mindless exploitation of arable land can cause loss of fertility resulting in the desertification of land.
5. The reason for the disappearance of the Aral Sea was the construction of two dams called Amu Dacrya and Syr Dacrya for irrigation purposes.
6. The poisonous gas that caused the 1984 Bhopal Gas Leak Tragedy was methyl carbonate.

3.5 SUMMARY

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- The human developmental process has affected our environment and ecology in a variety of ways.
- Development had led to pollution (air, water, and soil), deforestation, desertification, loss of biodiversity, etc.
- Environmental pollution means the process through which different kinds of human activities make natural resources harmful by adding pollutants like harmful gases, chemicals, industrial and human waste.
- Global Warming refers to the gradual rise of world temperature since the 19th century. Scientists have proved that this rise of the global temperature is directly related to the massive production of greenhouse gases.
- Deforestation is another consequence of the development of human civilisation. Most of the agricultural land and lands for other human settlements have been converted from what earlier used to be forests.
- The loss of forests has led to the loss of global flora and fauna.
- Desertification is a process through which arable land is claimed by sand and natural vegetation is lost through manmade or natural causes. Mindless exploitation of arable land can cause loss of fertility resulting in the desertification of land.
- In the aftermath of decolonisation, countries in the Global South have undertaken huge projects of socio-economic development.
- For a very long period, they were unaware of the detrimental impact of these projects on the environment. However, the need to address poverty and hunger compelled them to carry on their economic development projects.
- Developing countries argued that they need to address their basic needs first and the environment concerns can wait. However, they soon realised that this strategy will not work in the long run. The pressure created by domestic and global civil society has forced these countries to start worrying about environmental issues.
- The main goal of the Green revolution was to make India self-sufficient in the production of the food grains. The supply of hybrid seeds of wheat, massive use of fertilisers and chemicals were sanctioned as acceptable ingredients of the development project.
- In few years, production of food grains increased sufficiently and India became self-sufficient. However, soon it became clear that the achievement of self-sufficiency was at the cost of environment and the local ecology.
- One of the best examples of a development project becoming an ecological disaster is the lake called the Aral Sea in the erstwhile Soviet Union in

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Central Asia. It has been estimated that in the last 40 years more than 60 percent of the Aral Sea has disappeared.

- In April 2010, offshore oil mining by British Petroleum (BP) in the Gulf of Mexico near the USA resulted in an oil leak. Within a few days around 5 million barrels of oil spewed into the sea causing a huge ecological disaster. The Gulf of Mexico is home to different species of fish and other species. The oil spill has partially killed most of them.
- Another industrial disaster occurred in Bhopal. On December 4, 1984, more than 8000 people died immediately as a poisonous gas called methyl carbonate leaked from the Union Carbide factory in Bhopal. The effects of the leak are still causing various diseases in the local population today.

3.6 KEY WORDS

- **Ozone Layer:** The ozone layer is a layer in Earth's atmosphere containing relatively high concentrations of ozone (O3). It helps absorbs 97–99% of the Sun's medium-frequency ultraviolet light which had the potential to damage exposed life forms on Earth.
- **Genetically Modified Seed:** Genetically modified seeds are seeds of plants whose DNA has been modified using genetic engineering techniques to resist pests and agents causing harm to plants and to improve the growth of these plants to assist in farmers' efficiency.
- **Global South:** The Global South is made up of countries in Africa, South America and Asia who were primarily colonies of the Global north.

3.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What is environment pollution? How does it occur?
2. Write a short note on Green Revolution.
3. Write short notes on (i) Deforestation; (ii) Desertification.

Long Answer Questions

1. Discuss the ecological costs of any two agricultural initiatives in India.
2. Explain how the construction of dams has caused large scale displacement of dams in India.
3. Describe any two large scale industrial accidents that have occurred in the recent past.

3.8 FURTHER READINGS

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BLOCK-II

POPULATION - POVERTY AND SOCIAL WELFARE

UNIT 4 POPULATION

Structure

4.0 INTRODUCTION

Like developed countries, where two-thirds of people lives in the cities, urban population in India is increasing slowly but steadily due to migration from rural areas and industrialization. There are twelve big cities with more than ten lakh population. Interestingly, at a given period, female migration is greater than male migration. Of course, there are challenges in analysing the impact of population growth. For an effective planning of the country, population projections are essential. Quantitative and qualitative analysis are essential to understand the growth trend of the country. Academicians, demographers and institutions like the United Nations, Central Statistical Organizations, erstwhile Planning Commission, etc. initiated population projections.

Census was started to exactly know the population and is now done systematically once in a decade. The year 1951 was a landmark in the history of census operation in India as this was the first census in the free India. Several factors like early marriage, low literacy among women have added to population growth. In this unit, you will learn about population growth and the measures of population growth. The measures of population growth is an important tool that helps to determine the human population with the help of graphs or statistical methods.

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4.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the unequal population growth in rural and urban areas in India
- Get an insight into distribution of population according to age and sex
- Know about population projection and its uses
- Examine the demographic scenario of population growth
- Explain the various factors of population growth in India
- Describe the various measures of population growth

4.2 POPULATION GROWTH- AGE COMPOSITION OF POPULATION

Like other third world countries, the urban population of the country is increasing very slowly. Despite the growing migration from rural to urban areas, the population living in the urban areas is only 25 to 30%. As per the Handbook of Urban Statistics 2019, 'The level of urbanization in the country as a whole increased from 25.7 percent in 1991 to 27.82 percent in 2001 and to 31.14 percent in 2011 – an increase of 3.3 percentage points during 2001-2011 compared to an increase of 2.1 percentage points during 1991-2001.' The concept of an urban area was not defined properly in India till 1960. In 1960, India adopted a strict definition for the concept.

Migration from rural areas to urban areas is increasing every year. Earlier, maximum migration was towards Mumbai, followed by Delhi. Lower migration was observed in the states of Rajasthan, Madhya Pradesh, Bihar and Uttar Pradesh. The high rate of migration in Assam is due to industrialisation. In India, instances of female migration is more than male migration because women migrate to their husband's place after marriage.

Today, the trend of migration has changed a lot. Mumbai has the highest percentage of migratory population. Urban population is increasing day-by-day in India. Earlier, urbanisation was due to the World Wars, whereas now it is mainly due to industrialisation.

After independence, life expectancy for both genders has increased a great deal. In 1951, the life expectancy for males was approximately 32 years while for females it was approximately 31 years. This increased to 60.6 years for males and 61.7 years for females by 1996. And as per the National Health Profile, 2019, 'life expectancy for females is 70.2 years and 67.4 years for males' for the period 2012-2016.

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Table 4.1 Percentage Distribution of Projected Population by Age and Sex, 1996–2016, India

Age	1996			2001			2011			2016		
	M	F	P	M	F	P	M	F	P	M	F	P
0-4	12.6	13.0	10.6	10.6	10.8	10.7	10.1	10.2	10.1	9.7	9.7	9.7
5-9	13.2	13.3	11.3	11.3	11.6	11.5	9.4	9.4	9.4	9.3	9.3	9.3
10-14	11.9	11.5	12.1	12.1	12.1	12.1	8.9	9.0	8.9	8.7	8.7	8.7
15-19	9.9	9.5	11.0	11.0	10.5	10.8	9.7	9.9	9.8	8.3	8.3	8.3
20-24	8.6	9.0	9.1	9.1	8.7	8.9	10.4	10.3	10.3	9.0	9.1	9.1
25-29	7.8	8.5	7.9	7.9	8.2	8.0	9.4	8.9	9.2	9.7	9.5	9.6
30-34	7.0	7.2	7.2	7.2	7.7	7.4	7.8	7.3	7.6	8.7	8.2	8.5
35-39	6.2	6.0	6.4	6.4	6.6	6.5	6.7	6.9	6.8	7.2	6.8	7.0
40-44	5.3	5.0	5.6	5.6	5.5	5.5	6.0	6.5	6.2	6.2	6.4	6.3
45-49	4.4	4.2	4.7	4.7	4.5	4.6	5.3	5.4	5.4	5.5	5.9	5.7
50-54	3.6	3.4	3.9	3.9	3.7	3.8	4.6	4.6	4.5	4.8	5.0	4.9
55-59	2.9	2.8	3.1	3.1	3.0	3.1	3.7	3.6	3.6	4.0	4.0	4.0
60-64	2.4	2.4	2.4	2.4	2.4	2.4	2.9	2.8	2.9	3.2	3.1	3.1
65-69	1.7	1.8	1.9	1.9	1.9	1.9	2.1	2.1	2.1	2.3	2.4	2.4
70-74	1.3	1.2	1.3	1.3	1.3	1.3	1.4	1.5	1.4	1.6	1.6	1.6
75-79	0.5	0.5	0.8	0.8	0.8	0.8	0.9	1.0	1.0	0.9	1.0	1.0
80+	0.8	0.8	0.6	0.6	0.6	0.6	0.8	0.8	0.8	0.8	0.9	0.9
All	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Report of the Technical Committee on Population Projections constituted by Planning Commission 1996, Registrar General of India.

Key: *M: Male; F: Female; P: Population*

Table 4.1 delineates the distribution of population according to age and sex based on projections made in 1996. The table shows that the percentage of population below the age of five would decline from 10.6% in 1996 to 9.7% in 2016. Conversely, the population of ages 20-24, 25-29 and 30-34 would increase from 9.1, 7.9, 7.2 in 1996 to 9.1, 9.6 and 8.5 in 2016 respectively. As the ages 20-24, 25-29 and 30-34 are considered the most productive in an individual's life, it has been predicted that India would face a demographic dividend in the early part of the 21st century.

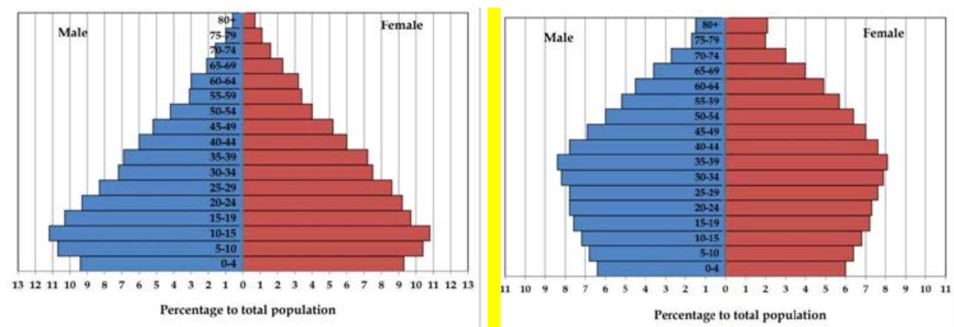
Population Projections as per Report in 2019

Table 4.2 Projected Total Population As on 1st March - India: 2011 - 2036 ('000)

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Year	Persons	Male	Female
2011	1210855	623271	587585
2016	1290235	663346	626889
2021	1361343	698959	662384
2026	1423435	729604	693831
2031	1475519	754893	720626
2036	1518288	775702	742586

Source: Adapted from the Population Projections for India and States (2011-2036), 'Report of the Technical Group of Population Projections, November 2019'



Source: Population Projections for India and States (2011-2036), 'Report of the Technical Group of Population Projections, November 2019'

Figure. 4.1 Projected Population Pyramid -Actual 2011 vs Projected Population Pyramid 2036

When it comes to age, the following projections are being made:

Between 2011 and 2036, because of the declining fertility, the proportion of population aged under 15 years is projected to decline from 30.8 to 19.8 percent; the proportion of the middle age-group (15- 59 years) and the older ages (60 years and above) are set to increase considerably. With the declining fertility, along-with the increases in life expectancy, the number of older persons in the population is expected to increase by more than double from 10 crores in 2011 to 23 crores in 2036 - an increase in their share to the total population from 8.4 to 15.0 percent. The proportion of population in the working age-group 15-59 years is expected to rise from 60.7 percent in 2011 to 65.1 percent in 2036.

Indian census has divided six types of cities according to population. The number of cities in the higher grade is increasing whereas the lower grade cities are slowly decreasing in India. There are twelve big cities with more than 10 lakh

population. According to the 1991 census, only 25.72% of the population lived in the cities, whereas according to the 2001 census, 27.8% of the population lives in the cities. And as per 2011 census, 31.16% of the population lives in urban areas.

Population and Demographic Projections

Though there are many criticisms on population projections, its uses are recognized by society. For effective planning of the country, population projections are essential. Trends in population growth, composition, etc. give an idea of the country's future. Both quantitative and qualitative analyses are essential to understand the growth trend of the country. Generally, it is found that projections given by the demographers are more accurate than others. A population estimator (projector) tries to estimate the size and growth rate of the future population on the basis of past and present demographic rates like death, birth and migration. Population projection is in relation to time.

Population Projection in India

Projections are made by academicians, demographers and institutions like the United Nations, Central Statistical Organizations, Planning Commission, etc. In 1949, Kingsley Davis made three projections for India. Though his predictions were far removed from reality, his projections had given theoretical knowledge for academicians and demographers. In 1951, Census Commissioner and Registrar General of India Mr. R.A. Gopalasamy predicted the Indian population. Both Kingsley Davis and Gopalasamy used geometrical growth rate. In 1954, Gupta and Majumdar projected population using Reverse Survival Method. In 1959, the Government of India projected its population till 1981. Besides these, there are several agencies and experts who have given population estimates for the country.

In 1996, before the formulation of the 9th plan, the Planning Commission had constituted a technical committee for population projections for the country for the period 1996 to 2016. The committee was revived from time to time. The latest Technical Group on Population Projection was constituted for making projections for the period between 2011 and 2036. The report came out in 2019.

Demographic Scenario: Past, Present and Future Challenges

The demographic scenario of population growth with reference to the past, present and the future can be understood taking into consideration the following factors:

1. Size and growth
2. Rural and urban population
3. Sex and age composition
4. Expectation of life at birth
5. Density

6. Growth rate
7. Literacy

Population of India can be discussed in two broad periods namely:

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(i) The pre-modern period (before 1881)
(ii) The modern period (after 1881 till date)

The year 1881 is considered as the cut-off period as it is the first time census operations were done in India.

In ancient times, there was no systematic way to enumerate the population. History shows that India was one of the most populous states of the world between 490 B.C. and 297 B.C. Alexander's army invaded India in 4th century B.C. and left behind large numbers in the region. Pran Nath, who later studied Indian population, confirmed that India's population was between 100 and 140 million during 300 B.C. There was a stagnant population till around A.D. 1600. This is evident from history. Moreland says that India's population during Akbar's period was 100 million. Later demographers and population experts like Davis, Das Gupta, Datta also agreed that the Indian subcontinent had a population of 100 to 140 million population during A.D. 1600. Between 1650 and 1800, the population of India was not stable and according to estimates, there were lots of fluctuations in the population. Mahalanobis and Bhattacharya estimated the Indian population to be 207 million in the year 1800.

In the modern period, the growth of population was rapid at certain points and declining or stagnant at some other points. The first census was conducted in India in 1881; it had several shortcomings. Many areas were left out in this census. In 1901, all the left-out territories in the earlier census were covered. Till 1931, census was done as a 'one night affair'. Since 1941, the system of census has changed to the present style. The history of population growth in India since 1891 can be divided into three parts:

1. 1901–1921
2. 1921–1951
3. 1951–1991

The year 1921 was referred as the year of the 'great divide' due to population growth in India. It is a well-known fact that from 1901 to 1921, there were lot of famines and contagious diseases which were the main reasons for the decline of the population. Following the 'great divide', India's population increased from 236 million to 251 million. This was the period when the mortality period was higher than the fertility rate.

From 1921 to 1951, the population growth fluctuated and the rate of population growth was 1.3% per annum. The size of the population increased from 251 million in 1921 to 361 million in 1951. In 1991, the size of the population reached 843 million. The year 1951 was another landmark in the history of census

operation in India as this was the first census in independent India. The mortality rate decreased considerably during this period.

Causes of Growing Population in India

In India, the age of marriage is still very low and the preference for a son still exists in the minds of Indians. Literacy rates are low particularly in the case of females. Male-female ratio is becoming increasingly unfavourable to women and mortality rates have reduced further. The birth rate in India is so high that it is higher than what the economy can sustain at the existing level of development. It is the ever-growing numbers which have made our population a matter of serious concern. Planning for such a large population is a very hard task.

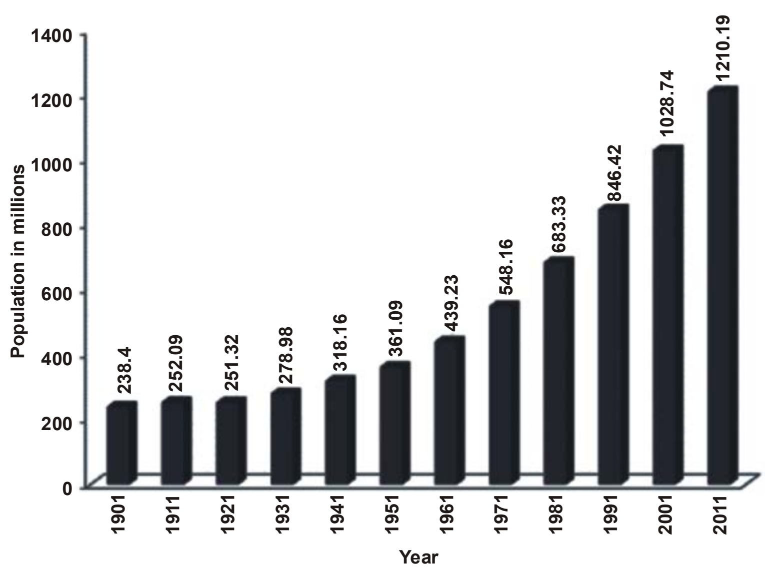


Figure. 4.2 India Population Increase

Source: http://en.wikipedia.org/wiki/File:India_population_increase.GIF

In March 2001, the number of Indian population was 102.7 crore. According to the 2011 Indian census, the population of India was around 121 crores.

Demographic Factors

1. Gap between Birth Rate and the Death Rate

Today, the rate at which development is taking place is very fast. The changing social circumstances and the advancement of science and technology has given a long life to human beings. In other words, the mortality rate has considerably decreased and the life span has increased. Though it is a healthy sign of development, the other component of the population, namely, the birth rate, is still very high in the country.

2. Early Age of Marriage

Reproductive behaviour starts from marriage. Marriage is the permission for the sexual activity in Indian society. Though there are premarital sexual activities, the culture does not permit them. A young age at the time of marriage is one of the causes of high fertility in India which, in turn, is the cause of the growing population. N.C. Das, in his study, observes that women marrying between the age of 20 and 24 have the same fertility rate as those who marry before 20. A woman who marries after 25 has low fertility behaviour. The average age of marriage for females in India was only 12.54 years in 1891. This was because the practice of child marriage was rampant in the country. After Independence, many social programs were undertaken to stamp out the practice of child marriages. It had a modicum of success. The average age of marriage for females increased to 17 by 1971. However, today, the average age of marriage in India for women is still 19 years. As a result, the reproductive behaviour of Indian women is still very high.

The legal age of marriage in India is 18 years for females and 21 for males. It is estimated that in our country 26% of the females marry at the age of 15 and 54% marry before they reach 18 years. Adolescent marriages are high in Bihar, Rajasthan, Manipur and Goa.

3. Fertility Rate

It is understood that in India most childbirths occur during the fifteen to nineteen years. Fertile union starts with the age of effective marriage and it continues up to death. Other causes behind the stoppage of fertility are separation, crossing of the maximum fertile age, which is considered as 50 years, etc. The fertility of the female is an important factor affecting reproduction and consequently increasing the population. According to Prof. Visaria, the general fertility rate should be reduced significantly.

4. High Reproductive Age Group

Almost fifty-eight per cent of our population is in the reproductive age group. It is estimated that between the years 1991 and 2016, a population of 417.2 million will be added, despite the adoption of small family norm by many states. This momentum of increase of population is because the total fertility rate was very high earlier and the reproductive population in the total population is still very high. India has to follow the small family norm very strictly in the coming years to reduce the size of its population.

Higher fertility is also due to the unmet demand for contraception. At present, India has around 169 million eligible couples and the country can meet the contraceptive needs of only 22% of this population. Contraceptive knowledge is also very low in India. In rural areas and in some pockets of urban areas, contraceptive knowledge is almost nil. With twenty to thirty per cent of males and ten per cent of females being sexually active before marriage, there is a need for

contraceptive knowledge. The abortion rate in India is very low when compared to other countries.

Most Indians still want large families. The traditional joint family is an Indian feature that people respect even today. Another demographic reason is the male attitude towards family planning. Research has revealed that the adoption of family planning methods is considered to be a women's job.

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5. Economic Factors

Human behaviour is very dependent on the economic aspects of the region where a person lives. Even fertility, mortality and other demographical features are dependent on economic factors. Occupation and income are the two most important economic factors which influence fertility behaviour.

6. Predominance of Agriculture

It is a well-known fact that more than seventy per cent of the Indian population lives in rural areas and is engaged in agriculture directly or indirectly. From the beginning of the 20^{th} century, the pattern of agriculture has been the same. Occupational distribution is almost a permanent feature in India. In rural India, every child is considered an asset as he/she is a free farm labourer. It is for this reason that children are not considered an economic burden in agrarian societies. So agricultural families prefer bigger families with more children. On the contrary, in industrial societies, as parents have to support the children, they prefer small families and thus the number of children is usually less.

7. Occupation and Fertility

It is observed that white-collar workers have fewer children than blue-collar workers. Likewise, fertility behaviour is positive in nature in those families where wives are also white-collar workers. As mentioned above, in the rural areas where people are mostly engaged in skilled jobs, the size of the family is large as compared to their counterparts in the urban areas.

8. Slow Urbanisation Process

The urban population in India is very less when compared to the European countries. In European countries, almost seventy per cent of the population lives in urban areas whereas in India even after seven decades of independence, only approximately 31 per cent of the population lives in urban areas. In 1951, only 17.62 per cent of the population lived in urban areas. Thus, the pace of urbanisation is very low in India. Those who are living in the rural areas have access to technology and knowledge. Though there are many demerits of living in the urban areas, people are aware of the importance of the small families and the importance of children in modern society. Upbringing of children in cities is difficult. In the villages, children grow on their own whereas in the cities, every stage is difficult as competition is very high. The cost of living is high in the cities and this reinforces

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the parents to think before they go for the 'next' child. In the countries where urbanisation is more, the fertility rate is low whereas in the non-industrialized areas, the fertility rate is high.

9. Income and Fertility

Many studies reveal that the number of children born per couple decreases with the increase in the per capita monthly income or expenditure of the household. This phenomenon is seen both in the urban and rural areas. A better income provides a better lifestyle and therefore parents do not want to take any risk by having more children and destroying the atmosphere of the family.

Another factor which is responsible for a higher rate of fertility in India is widespread poverty. As per RBI, around twenty-two per cent of the Indian population lives below the poverty line. Many rural families which does not have an occupation or other leisure indulge in sexual activities which leads to an increase in the number of children. Moreover, in rural families and many other poor families, each child is an economic asset. In one report, the World Bank has stated that 'there are good reasons why, for poor parents, the economic costs of children are low, the economic benefits of children are high and having many children makes economic sense.'

Educational Factors

Illiteracy is widespread in India. As per Educational Statistics report released by MHRD in 2018, 'The overall literacy rate in India is 69.1 per cent. The number includes the literacy rate in both rural and urban India. The number pertains to 2014.' Female literacy rate is more concentrated in urban areas. Female illiteracy is more in the northern states, namely Uttar Pradesh, Bihar, Rajasthan and Madhya Pradesh. In India, almost all the scientists and planners agree that only education can change the attitude of the people, especially towards the composition of family and the components of the family like marriage, girl child, size of the family, etc.

Education brings about a total change in the personality of an individual. If both the couples are educated the perception towards marriage and family is positive in nature and which helps the couple to plan the family. A few years of formal schooling bring a perceptible change in the reproductive behaviour. Thus, there is a causal relationship between education and fertility behaviour.

Education is capable of changing the minds of people in two ways. Firstly, it changes the attitude of the people. Secondly, it gives an awareness regarding hygiene, diseases, etc. Education influences both the parents and the children. A higher level of education is correlated to higher age of marriage, small family size, wide spacing between the children, etc. Studies have revealed that the mother's education is more strongly correlated with the couple's fertility intentions than the education of her spouse. If the mother's education has reached secondary and higher levels, the impact is greater. Children's education also affects the fertility

behaviour. When the parents have high aspirations towards children's education, the size of the family tends to be smaller than in families where the parents do not plan their children's education properly.

Psychological and Religious Factors

Most of the psychological factors have a religious base. One of the most important psychological factors which operates in Indian families is that children are expected to retain the family name. It is a pleasure for many families to share their resources with the children. Another factor is the dependency factor. In a country where there is not much scope for the old, parents feel that they have to depend upon the children during their old age. Many parents feel that it is nice to have more than one child so that at least one of them will look after them during their old age. Psychologically, many parents feel secure when there are children with whom they can share their happiness and sorrows.

Hinduism states that only a son can perform the last rites and a daughter must be given away in marriage. Thus, both sons and the daughters are necessary for a man to get *Moksha*. The other religious beliefs are that children are God-given gifts. Marriage is considered a religious affair by almost all religions. It is assumed that a couple without children has borne the curse of the God. Thus, couples try everything to have children, especially sons.

Social Factors

India's growing population is mainly due to social factors existing in the country. Universality of marriage, low age of marriage, religion and superstitious beliefs, joint family system, etc., are some of the important social factors which influence the fertility rate.

1. Lower Age at the Time of Marriage

India is one of the countries where marriages usually take place at a lower age. Studies show that the fertility rate decreases only when brides are above twenty-five. The National Policy of Population announced the minimum age of marriage of girls at eighteen years and boys at twenty-one years. S.N. Agarwala said, 'It has been calculated that an increase in the mean age of the marriage of females by six and half years during the period 1891-1901 to 1981-1991 in India has resulted in a 4.3% decline in the birth rate over the period'.

Marriages in India had some peculiar rules and accordingly widow remarriage was prohibited. An act was passed permitting widows to remarry in the year 1891. According to Dr. Chandrashekar, 'There are about twenty-four million widows of all ages, including virgin widows who normally do not marry. Even widowers do not marry as a rule. But India is in fact changing and, of late there are some men who are willing to marry eligible and unencumbered widows.'

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2. Universality of Marriage

Marriage is both a religious and social phenomenon in India. It is more acceptable for a daughter to get married at a suitable age according to religious sanctions. According to the statistics, only five out of 1,000 Indian women remain unmarried in India by the age of fifty. The average age of marriage is also very low in India as compared to other developed countries. Dr. Chandrashekar says that '… everyone in India, sooner or later usually sooner, gets married. Marriage is not merely a necessary social institution but a quasi-religious duty… spinsters and bachelors are a rare phenomenon in India and nearly every adult male and female in the country participates in reproduction.'

In our country, bearing of children is considered the most important duty of a married woman. Her status in her husband's house depends upon the level of her childbearing capacity. Even the gender of the child is important for the woman to get the right status in the husband's house. For example, if the woman is not able to bear a son, her status is low in her husband's house. The spacing of the children is also not determined by the couple but by the extended family. Thus, couples are not free to chart their reproductive behaviour.

3. Ignorance and Superstition

It is believed that children are a God-given gift. Sons are considered religious, social and economic resources. Manu's law has influenced every person in India irrespective of region and religion. Although various religious groups have their own rules and regulations regarding marriage and size of the family, all religions believe in universality of marriage and the necessity of bearing children.

4. Joint Family System

The joint family system is one of the convenient systems for bringing up children. In the traditional joint family system, children are considered as common property and the parents never take care of their children. Children grow on their own or the adults have equal responsibility in taking care of the children. As difficulties are not experienced by parents in bringing up the children, planning of the family is seldom done. There is a kind of social insurance in a joint family for children and adults. Hence, the population in a joint family is not a problem at all. In traditional India, marriage was the only function for women. Thus, parents and the girl looked forward to these functions. As soon as the girl attained puberty, parents gave her in marriage. Also, since the mortality rate was high in earlier days, people did not want to stop the family size. This also added to population growth. Prof. Jayasurya points out, 'In a society which practised agriculture of the traditional type, a large number of children was an advantage. Even if a few of them did not survive beyond 10 or 12, they fulfilled at these and younger ages as well, certain functions of economic nature, such as tending cattle or sheep, or carrying out simple tasks in the field.'

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5. Status of Women

Today, the majority of women are aware of the small family norm. Working women prefer fewer children and follow this norms. In traditional society the status of women depended on the number of children. In fact the number of the male children counted to determine the status of the mother. Even today in India, a childless mother is looked down upon by society. Other social causes are infant mortality and absence of sex education.

4.3 MEASURES OF POPULATION GROWTH

The measurement of population growth is an important tool in the field of demography as it helps to determine the human population and its trends which significantly helps in development of the country. Population growth can be analysed with the help of graphs or statistical methods. The two most important statistical measures are gross reproduction rate and net reproduction rate, which have been discussed as follows:

1. **Gross Reproduction Rate (GRR):** In order to calculate the gross reproduction rate, we take into account only the number of mothers who are expected to give birth to female child. According to American demographers Warren Thompson and David Lewis, 'Whereas Total Fertility includes all births both male and female, the gross reproduction rate shows how many girl babies – potential future mothers – would be born to 1000 women passing through their child bearing years, if the age specific birth rates of a given year remained constant and if no women, entering the child bearing period died before reaching menopause.'

   According to this concept, all girls are included with the presumption that they will enter their respective reproductive ages, bear children and would complete the process of reproduction.

   Gross reproduction rate is computed by multiplying the total fertility rate by the percentage of all female births. If the product is 1000 or more, it means that 1000 or more female births have taken place by each 1000 women of child bearing age. It is important to remember that while calculating it, no account is taken of the deaths of the women during their reproductive period.

   Gross reproduction rate is represented as:

$$GRR = \frac{Number\ of\ female\ births}{Total\ number\ of\ births} \times Total\ Fertility\ Rate$$

   For calculating GRR, we assume certain conditions which are as follows:

   - That out of female children born, all will live through the child bearing period of the age group between fifteen to 'fifty' years.

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- That the age specific birth rates prevailing will continue throughout the child-bearing life of the group of women under consideration.

2. **Net Reproduction Rate (NRR):** The net reproduction rate (NRR) is the average number of female births that would be born to a female (or a group of females) if she has passed through her lifetime conforming to the age-specific fertility and mortality rates of a given year. Net reproduction rate indicates the average number of future mothers born to a mother of today. It is an index of replacement potentiality of a population with given age specific rate of fertility and mortality.

   The NRR is computed by applying the age specific birth rates to the number of years lived in each group by the survivors of the original cohort after mortality has operated, summing the products, and then applying the ratio between female born and the total births, and dividing the result by 1000. The net reproduction rate was first found out by Kuczynsky.

$$\text{NRR} = \frac{\sum(\textit{Number of female births} \times \textit{Survival Rate})}{1000}$$

   In order to calculate the NRR, we take into account the following points:

   - We divide the mothers into different age-groups such as 15-19, 20-24, 25-29, and so on.
   - We take into account the female children born of mothers of every age group.
   - We will deduct the number of female children who die before they attain the reproductive age, the unmarried female children and widows.

   If the net reproduction rate is equal to one (NRR=1), the population is stationary i.e., the new mothers are just replacing the old mothers; if the net reproduction rate is greater than one (NRR>1), the population is increasing; and if the net reproduction rate is lesser than one (NRR<1), the population is decreasing.

Stationary and Stable Population

There are two types of population which are discussed as follows:

Stable Population

The concept of a stable population was first introduced into demography by Alfred J. Lotka as a particular case of a Malthusian population. A population is called stable when both its growth rate and its relative age distribution does not undergo a change over a period of time. Thus, we can say that the size of stable population grows or diminishes at a constant rate, but each age group has a constant share.

The size of each age group grows or diminishes with the same (constant) rate as the size of whole population. The theory holds that if a population which is

closed to migration undergoes a constant schedule of fertility and mortality over a long period of time, it will ultimately lead to a population which grows at a constant rate but in which age structure remains unchanged.

Nico Keilman in his lecture gave few properties of stable population which are as follows:

- **Property 1:** The number of births and the number of deaths in a stable population change with the same rate. This rate is constant and it equals the growth rate of the population. Thus the crude birth rate (CBR) is also constant, and so is the crude death rate (CDR), although the CBR and the CDR are usually not equal to each other. In other words,

  Growth rate (=natural growth rate) = CBR - CDR= constant.
- **Property 2:** Any two sets of time-constant age-specific birth rates and age-specific death rates, when applied to a population with a certain initial age distribution, will in the long run, result in a stable population. The growth rate and the age distribution only depend on the birth rates and the death rates. The ultimate (stable) age distribution will have a regular form. The case will remain the same even if the initial age distribution was not stable.

The use of stable population theory

Stable population theory is frequently used when there is lack of certain population data (for example the CBR) while we may know some of the other data (for example the age distribution) with certainty. Stable populations are also used for theoretical models which is used by demographers to represent and understand the structure, growth and evolution of human population.

Stationary Population

Stationary populations are the simplest form of stable populations. A stationary population is a special example of a stable population which has a zero growth rate which is neither growing nor shrinking in size, and is equivalent to a life table population.

The size of a stationary population will, by definition, always remain the same, and the crude birth rate and crude death rates will always be equal. Age-specific fertility and mortality rates are constant, and their net effects cancel out – that is, for a given period there will always be equal numbers of births and deaths.

In a stationary population, the proportion in each age group is constant as in any stable population, but unlike a growing or shrinking stable population, the numbers in each age group are also constant over time. The nLx column of the life table provides the resulting stationary population; it is the number of persons in such a population between ages x and $x+n$. The proportion of population in age group x to $x+n$ is

$nCx = nLx / To$

$= lo/ To \times nLx/lo$

$= b \times nLx/lo$

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Where b is the birth rate and nLx/lo is the chance of survival from birth to age group x to x+n. Birth and death rates of such a population are equal and the growth rate is zero.

Check Your Progress

1. What per cent of the population is living in urban areas in India?
2. List the types of cities divided by Indian census on the basis of population.
3. What do you understand by population projection?
4. While assessing the population growth, which year was referred as the year of 'great divide'?
5. List some of the causes for growing population in India.
6. How is gross reproduction rate computed?
7. What is the premises of net reproduction rate?
8. When is a population termed as stable?

4.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Like many other third world countries, the urban population of the country is increasing very slowly. Despite the growing migration from rural to urban areas, the population living in the urban areas is only 25 to 30%. The increase in the urban population from 1901 to 1991 has only been 15%, i.e., the increase of population from 10.8% to 25.8%.
2. Indian census has divided six types of cities according to population. The number of cities in the higher grade is increasing whereas the lower grade cities are slowly decreasing in India. There are twelve big cities with more than 10 lakh population. According to the 1991 census, only 25.72% of the population lived in the cities, whereas according to the 2001 census, 27.8% of the population lives in the cities.
3. Population projections are made by academicians, demographers and institutions like the United Nations, Central Statistical Organizations, Planning Commission, etc. In 1949, Kingsley Davis made three projections for India. Though his predictions were far removed from reality, his projections had given theoretical knowledge for academicians and demographers.

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4. The year 1921 was referred as the year of the 'great divide' as it distinguished the population growth from a lesser speed to greater speed. It is a well-known fact that during the period of 1901-1921, there were lot of famines and contagious diseases which were the main reasons for the decline of the population during this period. During this period, India's population increased from 236 million to 251 million. This was the period when the mortality period was higher than the fertility rate.
5. In India, the age of marriage is still very low and the preference for a son still exists in the minds of Indians even today. Literacy rates are low, particularly in the case of females. Male-female ratio is becoming increasingly unfavourable to women and mortality rates are to be reduced further. The birth rate in India is so high that it is higher than what the economy can sustain at the existing level of development. Since 1951 our population has more than tripled. It is the ever-growing numbers which have made our population a matter of serious concern. Planning for such a large population is a very hard task.
6. Gross reproduction rate is computed by multiplying the total fertility rate by the percentage of all female births.
7. Net reproduction rate is an index of replacement potentiality of a population with given age specific rate of fertility and mortality.
8. A population is termed stable when both its growth rate and its relative age distribution does not undergo a change over a period of time

4.5 SUMMARY

- Like other third world countries, the urban population of the country is increasing very slowly. Despite the growing migration from rural to urban areas, the population living in the urban areas is only 25 to 30%.
- Migration from rural areas to urban areas is increasing every year. In earlier days, the maximum migration was towards Tripura, followed by Delhi. Lower migration was observed in the states of Rajasthan, Madhya Pradesh, Bihar and Uttar Pradesh. The high rate of migration in Assam is due to industrialisation.
- Though there are many criticisms on population projections, its uses are recognized by society. For effective planning of the country, population projections are essential. Trends in population growth, composition, etc. give an idea of the country's future. Both quantitative and qualitative analyses are essential to understand the growth trend of the country.
- The first census was conducted in India in 1881; it had many shortcomings. Many areas were left out in this census. In 1901 while census operations were made, all the left-out territories in the earlier census were covered. Till

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1931 census was done as a ‘one night affair’. Since 1941, the system of census has changed to the present style.

- The birth rate in India is so high that it is higher than what the economy can sustain at the existing level of development. This shows that since 1951. our population has more than tripled. It is the ever-growing numbers which have made our population a matter of serious concern. Planning for such a large population is a very hard task.
- The urban population in India is very low when compared to European countries. In European countries almost 70% of the population lives in urban areas whereas in India even after 57 years of Independence, only 25.7% of the population lives in urban areas.
- Education brings about a total change in the personality of an individual. If both the couples are educated, the perception towards marriage and family is positive in nature which helps the couple to plan the family. A few years of formal schooling bring a perceptible change in the reproductive behaviour.
- The growth of the Indian population has been a concern not only for our country, but for the whole world. Demographers all over the world have studied the patterns of growth of the Indian population and the consequences of this growth on the country.
- Generally infants, children and old people are unproductive consumers. But in India, there are many other unproductive consumers like the unemployed, underemployed and seasonally employed persons. A growing population also affects the per capita income, thus lowering the standard and quality of life.
- In order to calculate the gross reproduction rate we take into account only the number of mothers who are expected to give birth to female child.
- The net reproduction rate (NRR) is the average number of female births that would be born to a female (or a group of females) if she has passed through her lifetime conforming to the age-specific fertility and mortality rates of a given year.
- There are two types of concept of population which includes the following:

  Stationary population

  Stable population
- The concept of a stable population was first introduced into demography by Alfred J. Lotka as a particular case of a Malthusian population.
- A stationary population is a special example of a stable population which has a zero growth rate, neither growing nor shrinking in size, and is equivalent to a life table population.

4.6 KEY WORDS

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- **Census**: A census is an official survey of the population of a country that is carried out in order to find out how many people live there and to obtain details of such things as people's ages and jobs.
- **Demography**: The study of statistics such as births, deaths, income, or the incidence of disease, which illustrate the changing structure of human populations.
- **Population Estimate**: This refers a calculation of the size of a population Human Resources for a year between census periods or for the current year.
- **General fertility rate**: Number of live births per 1000 women between the ages of 15 and 44 years.

4.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Write a short note on urban population in India.
2. What is the role of migration in India's growing urban population?
3. List the demographic scenario of population growth in India with reference to the past, present and the future.
4. Write a brief note on the role of social factors in population growth in India.
5. What are the statistical measures of population growth?

Long Answer Questions

1. Explain the significance of population estimate.
2. Discuss in detail the causes of growing population in India.
3. Analyse some of the social factors responsible for high fertility rate in India.

4.8 FURTHER READINGS

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UNIT 5 NATIONAL POPULATION POLICY

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Structure

5.0 INTRODUCTION

In this unit, you will learn about the meaning and significance of population policy in the overall development of the country. The unit will also delve into the population policies and programmes introduced in India, while also stressing on the goals of these policies. The contribution of the Five-Year Plans will also be discussed in detail. Further on, the objectives of the National Population Policy 2000 will also be highlighted.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the meaning and importance of population policy
- Discuss the population policies and programmes introduced in India
- Describe the objectives of the National Population Policy 2000

5.2 POPULATION POLICY

In the beginning of the 20th century, several scientists and philosophers started thinking of population from qualitative and quantitative angles. While some countries were concerned about the quantity of the population, several other countries were concerned about the quality of the population. According to the famous demographer Frank Lorimer, 'Question of policy relative to population trends is, in large part, regional and specific. An attempt to treat the problems of the United States, Africa, France and Pakistan in the same terms is likely to promote confusion rather than enlightenment. Population concern has grown markedly throughout the

world in recent years, and with it the concern for population policy. The concern is not everywhere the same; that is, it is not everywhere expressed with the same knowledge or intensity nor even attached to the same objects. But nevertheless it is there'. What Lorimer was suggesting was that each country is different from the other and the demographic features are also different from one country to another. Each country faces its own problems regarding population issues. On the one hand, while Hungary and Canada are concerned with too low a population, Israel and South Africa are concerned with differential fertility. Thus, each country has to give thought to population planning and policies keeping in mind its own specific context.

Meaning of a Population Policy

Today, a population policy has become a common feature. There are region-specific population policies. Many private agencies are also engaged in designing population policies for regions and countries. A population policy is a social policy where the makers of the policy discuss various aspects of the policy. Population policies are like eye openers for social change that is taking place in the nation. It is a planned social change. According to Professor B. Berelson, population policy should have three specific features which are as follows:

- It is related to all the small and big actions including laws, by-laws, acts and ordinances enacted by the government.
- It gives the causes and effects of the population both in a quantitative and qualitative manner.
- It studies all the groups or different sections of the population.

The report of the ad hoc Consultative Group of Experts on Population Policy set up by the Population Commission of the United Nations Economic and Social Council published in 1972 stated, 'A population policy includes measures and programmes designed to contribute to the achievement of economic, social, demographic, political and other collective goals, through critical demographic variables, namely, the size and growth of population, its geographic distribution (national and international) and its demographic variables as well as those specifically designed to do so.' Professor P. C. Jain says that a population policy should be a thoughtful action, and it is a formulation programme by the State and Central Governments to reduce or increase the population by reducing or increasing the birth rate of the country.

Even philosophers like Plato and Aristotle talked about population. Plato was in favour of a limited population to maintain quality of life. On the other hand, mercantilists were in favour of a large population as it would provide cheap labour, which was necessary for production. Malthus, the classical demographer and social scientist, said that there was a relationship between the means of livelihood and population growth, and he warned society that if food production was not increased, population would become a problem. Unlike Malthus, Marx regarded

overpopulation only as a surplus of labour. History shows that the policies adopted in the earlier days were not that effective in reducing population or maintaining the quality of the population. No policy considered the reduction of the fertility rate and the policies were not able to control the death rate or international migration. Later, population policies started taking these factors into consideration. The subject matter of the population policy is the relationship between the demographic variables in context of size, rate, distribution and composition. These factors are affected by the economic, political, ecological and social conditions and norms prevailing in the country. The size of the population is the total number of the people in the country and the rate refers to fertility and the mortality rate of the population. Distribution is the density of the population. It also includes migration patterns. Finally, composition is the relationship between the population and the other socio-economic features of the country.

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Objectives of a Population Policy

The main focus of any population policy is the welfare of the country. It aims at a balanced population so that the country continues to develop and individuals live in a satisfactory socio-economic environment. The objectives of a population policy can be understood in four categories which are as follows:

- **(i) Economic:** One of the main objectives of the population policy is to maximize the per capita income, per capita housing and food availability. It also aims to provide employment, nourishment and education, and improve national production and productivity.
- **(ii) Political:** A population policy aims to provide justice, peace, freedom and equality.
- **(iii) Ecological and Environmental:** This is the most important aim of any population policy. It aims to bring ecological and environmental balance. Urbanization and industrialisation have to be considered while achieving this objective. People are very concerned regarding the destruction of nature due to population growth. Therefore, these factors are of utmost importance when formulating population policies.
- **(iv) Sociological:** This objective of the population policy is to obtain a quality population. It tries to enhance the level of education, cultural and aesthetic aspects, good health and security services. These aims can be achieved by keeping the population at an optimum level.

  There are five ways to achieve the above objectives which are listed as follows:

  - (i) Spread of information and education
  - (ii) Extension of voluntary programmes
  - (iii) Change in social institution

(iv) Provision of incentives and disincentives

(v) Imposition of coercion

There are mainly three types of population policies which are as follows:

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(i) Fertility-influencing policies

(ii) Mortality-influencing policies

(iii) Migration-influencing policies

Most of the countries follow the fertility-influencing policy as it is easy to control the birth rate. In countries where the birth rate is very low, migration-influencing policies are devised. Most of the developed countries follow migration-influencing policy.

Population Policy and Programmes followed in India

In India, the most important and the only component affecting the population is fertility. Regarding the other two components, namely, mortality and migration, migration does not have a significant effect on the population of India. As for international migration, the volume of such migration is not very large. Migration within the country is a constitutional privilege and the question of any special policy in this regard does not arise. Therefore, when the population policy of India is analysed, only fertility and mortality may be taken into consideration. India's population policy is a fertility-oriented one. The anti-natalist policy of the country is one of the first in the world. If one looks into the history of the population growth and the population policy of the country, one can see that a serious concern about a population policy came into existence only after independence. The British rulers of the country were not interested in the quantity or the quality of the Indian population. So, they were not interested in formulating a population policy for India. They took no interest in family welfare and family planning programmes. However, a section of the Indian elite took interest in the population of the country between the two World Wars, though the visible elite were interested only in the freedom movement. The high rate of mortality and density in some pockets was pointed out by a few scientists. The census in 1931 indicated an increase in the population and many people warned the country about the consequences of this increase in the coming years. They also advocated the need for a population policy for spreading the practice of birth control.

Between 1916 and 1947, many events related to population occurred. In 1925, the first Family Planning Clinic was opened in Bombay by R.D. Karve. The same year Rabindranath Tagore wrote, 'I am of the opinion that the birth control movement is a great movement, not only because it will save women from enforced and undesirable maternity, but also because it will help the cause of peace by lessening the number of surplus population of the country, scrambling for food and space outside its own rightful limits. In a hunger-stricken country like India, it is a cruel crime to thoughtlessly bring more children into existence than can be properly

taken care of, causing endless sufferings to them and imposing a degrading condition upon the whole family.' Then, the Mysore Government took the first step in opening the first Government Birth Control Clinic in the world. In 1931, the senate of the Madras University accepted the proposal to impart instructions regarding the methods of conception control. In 1935, the Indian National Congress set up a national committee under the chairmanship of Jawaharlal Nehru and gave the following recommendations:

- We agree with the view that the size of the Indian population is a basic issue in national economic planning, in so far as its unrestricted increase of proportion to means of subsistence, affects adversely the standard of living, and tends to defeat many social ameliorative measures. The problem has been fundamentally caused by the lack of all-round co-ordinated economic development. While measures for the improvement of the quality of the population and limiting excessive population pressure are necessary, the basic solution of the present disparity between population and standard of living lies in the economic progress of the country on a comprehensive and planned basis.
- In the interest of social economy, family happiness and national planning, family planning and limitation of children are essential: and the state should adopt a policy to encourage these. It is desirable to lay stress on self-control as well as to spread knowledge of cheap and safe methods of birth control. Birth control clinics should be established and other necessary measures should be taken to prevent the use or advertisement of harmful methods.
- We consider raising the eligibility of the marriage age and the discouragement of polygamy is desirable in the interests of the limitation of the size of the family.
- Programmes should include the sterilization of persons suffering from transmissible diseases of a serious nature such as insanity or epilepsy.
- The maintenance of vital statistics and the carrying out of periodic demographic surveys on comprehensive lines are necessary. Appropriate machinery should be devised for the purpose.

This was a historical recommendation for the country. In 1940, P.N. Sapru successfully moved a resolution in the Council of States for the establishment of birth control clinics. The Indian Independence Movement was in full swing during this time and several opinions came from the leaders regarding birth control, population control and economic development. Gandhiji was the most important person at that time and he was against the artificial means of birth control. He advocated moral standards to control births. He emphatically declared, 'There can be no two opinions about the necessity of birth control. But the only method handed down from ages past is self-control or *bramacharya*. It is an infallible

sovereign remedy doing good to those who practise it. The union is meant not for pleasure but for bringing forth progeny.' After independence, population growth got a new direction.

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The New Population Policy of India

After India attained freedom, high priority was given to population, its growth and its consequences on society. All the developments were related to population and each five year plan gave importance to controlling population growth. All five year plans have taken several measures to control the population. The draft outline of the First Five-Year Plan published in the year 1951 talked about 'Population Pressure and its Bearing on Development'. It came to the conclusion that the pressure of population in India is already so high that a reduction in the rate of growth must be regarded as a major desideratum. The second Five-Year Plan did not state any specific measures to check the population. However, it said that 'there is a need for a large and active programme aimed at restraining population growth, even as it reinforces the case for a massive developmental effort'. The Third Five-Year Plan clearly spelled out, 'The objective of stabilizing the growth of population over a reasonable period must therefore be at the very centre of planned development'. The Fourth and Fifth Five-Year Plans viewed population as an economic and social factor. Both the plans wrote the immediate need for the population checks for a better society. It was in the Fifth Five-Year Plan that the setting up of a National Population Policy was formally announced.

The National Population Policy announced in the year 1976 reiterated, 'The policy envisages a series of fundamental measures, including raising the age of marriage, female education, spread of population values and the small family norm, strengthening of research in reproductive biology and contraception, incentives for individuals, groups and communities and permitting state legislatures to enact legislations for compulsory sterilization'. It also stated, 'A target for a birth rate of 25 per thousand and a population growth rate of 1.4 per cent by the end of the sixth plan period is accepted and these targets are expected to be reached.' The sixth Five-Year Plan (1980–1985) earmarked ₹ 10,100 million for the family planning programme. In the seventh Five-Year Plan (1985–90), the outlay for the family welfare programme was ₹ 3,256 crores. In 1990, the Government of India set the following targets:

- Effective couple protection rate : 42 per cent
- Crude Birth rate : 29.1 per cent
- Crude Death Rate : 10.4 per cent
- Infant Mortality Rate : 90.0 per cent

Source: Government of India, S.F.Y.P (1985-90)

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As the sixth Five-Year Plan was successful in relation to the Family Planning Programme, the seventh Five-Year Plan decided that the programme related to sterilisation should continue with great momentum, besides educating people and telling them the advantage of late marriage. It also emphasised that the child survival rate should be increased to achieve the standard of two children. The areas emphasised during this plan were as follows:

- The traditional structure of the programme should be made more effective and efficient.
- Each state should be liberal in providing funds for programmes within its structure.
- Special attention is to be paid to post-marital methods, especially for youngsters.
- There was a greater need for special programmes of information, education and communication for removing the feelings against the female foetus.
- Efforts should be made to educate people about the minimum marriage age.
- Special attention is required to raise the protection rate in areas like slums, tribal areas, etc.
- Each village should have *mahilamandals*, youth forums, etc.
- For achieving these goals, an integrated approach throughout the country is needed with political commitments.

Table 5.1 Targets and Achievements of Family Planning Acceptors

Period	**Sterilisation**		**I.U.D**		**Eq. C.C. and Oral Pills**		**Rise in Couple Protection rate**
	(T)	**(A)**	**(T)**	**(A)**	**(T)**	**(A)**	
1985–86	55.0	49.0	32.5	33.0	105	107	From 32% in April
							1985 to
1986–87	60.0	50.0	37.5	29.0	115	116	42% in March 1990
1987–88	62.5	49.0	42.5	44.0	125	134	
1988–89	65.0	47.0	47.5	48.0	135	143	
1989–90	67.5	42.0	52.5	49.0	145	159	

The Eighth Five-Year plan promulgated, 'Containing population growth has been accepted by the government as one of the six most important objectives of the Eighth plan, with the aim of reducing the C.B.R. from 29.9 per thousand in 1990 to 26 per thousand by 1997, and IMR from 80 per thousand in 1990 to 70 by 1997'.

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Table 5.2 Target for Eighth Plan (1992–1997)

Items	Targets in Lakhs
Sterilisation	3180.0
I.U.D.	350.0
C.C. and O.P. Users	1225.0
C.B.R. (per thousand)	26.0
I.M.R. (per thousand)	70.0

The National Health Policy of 1981 was an important development in the country as it related to the mortality-influencing policy of the country. This was taken up as an issue at Alma Ata's (USSR) Conference of WHO and UNICEF in 1978.

Table 5.3 Targets for Health Indicators, 1985,1990, and 2000

S. No.	Index	Present Level		Target		
				1985	1990	2000
1.	Infant Mortality	Rural:	136 (1978)	122	—	—
	(per 1000 live births)	Urban:	70 (1978)	60	—	—
		Total:	125(1978)	106	87	below 60
	Neo natal	Rural:	76(1978)	88		
	Post neonatal	Rural:	60(1978)	56		
	Prenatal Mortality	60-90		—	—	30-35
2.	Crude Death Rate					
	(Per 1000 population)	14.1 (1978)		11.6	10.4	9.0
3.	Pre School (1–5) Years					
	Mortality	30–40	25–30	15-20	10	
4.	Maternal Mortality Rate	4.8 (1976)		3–4	2–3	Below 2
5.	Life Expectancy at Birth	Male:	51.6	55.1	57.6	64 Yrs
		Female:	51.6	54.3	57.1	64 Yrs

Source: Govt. of India. Report of the working group on Health for all by 2000 A.D., New Delhi Ministry of Health and Family Welfare 1981.

Goals of Population Policy

From the above analysis, one can see the implications of the national population policy with regard to population growth, fertility and mortality. All the policies aim to reduce the population pressure so that the living conditions will improve. There are immediate objectives and long-term objectives for the population policies. The implications of the population policy are the attainment of these objectives.

The National Population Policy 2000, was envisaged in 1993 and formulated in 1994. But it was reviewed in 1999 and actually passed in the parliament in the year 2000 under the Ninth Five Year Plan. The goals of the National Population Policy 2000 were as follows:

- Address the unmet needs for basic reproductive and child health services, supplies and infrastructure.

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- Make school education up to age fourteen free and compulsory, and reduce drop outs at primary and secondary school levels to below twenty per cent for both boys and girls.
- Reduce infant mortality rate to below thirty per 1000 live births.
- Reduce maternal mortality ratio to below 100 per 100,000 live births.
- Achieve universal immunization of children against all vaccine preventable diseases.
- Encourage marriage of girls after eighteen years of age.
- Achieve eighty per cent institutional deliveries and 100 per cent deliveries by trained persons.
- Achieve universal access to information/counselling and services for fertility regulation and contraception with a wide basket of choices.
- Achieve 100 per cent registration of births, deaths, marriage and pregnancies.
- Contain the spread of AIDS and promote greater integration between the management of reproductive tract infections (RTI) and sexually transmitted infections (STI) and the National AIDS Control Organization.
- Prevent and control communicable diseases.
- Integrate Indian Systems of Medicine (ISM) in the provision of reproductive and Child Health Services and in reaching out to the households.
- Promote vigorously the small family norm to achieve replacement levels of TFR.
- Bring about convergence in implementation of related social sector programmes so that family welfare becomes a people-centred programme.
- Apart from the implications mentioned above, NPP also has long-term goals which are shown in the following tables.

Table 5.4 Anticipated Growth in Population (Million)

Year	If current trends continue		If TFR 2.1 is achieved by 2010	
	Total Population	*Increase in Population*	*Total Population*	*Increase in Population*
1991	846.3	—	846.3	—
1996	934.2	17.6	934.2	17.6
1997	949.9	15.7	949.0	14.8
2000	996.9	15.7	991.0	14.0
2002	1027.6	15.6	1013.0	11.0
2010	1162.3	16.8	1107.0	11.75

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Table 5.5 Projections of Crude Birth Rate, Infant Mortality Rate and TFR if the NPP 2000 is fully implemented

Year	Crude Birth Rate	Infant Mortality Rate	Total Fertility Rate
1997	27.2	71	3.3
1998	26.4	72	3.3
2002	23.0	50	2.6
2010	21.0	30	2.1

National Policy on Population Education–1986

The first National Seminar on Population Education was held in 1969 and emphasised the need for population education in schools so that complete awareness on population could be initiated at the school level itself. From 1980 onwards, population education became a national programme under the banner of the National Population Education Programme by the Ministry of Education. In 1988, almost all the states followed the programme. In 1986, the National Policy on Population Education was implemented. The policy gave importance to education for women and children in order to bring down the population. It emphatically said that the spread of education and literacy could be the largest single factor to reduce population growth. The policy mentioned that empowerment of women through education was necessary to develop quality population.

The policy also stated, 'The National System of Education will be based on a national curriculum framework which contains a common core along with other components that are flexible. The common core will include history of India's freedom movement, the constitutional obligations and other content essential to nurture national identity. These elements will cut across subject areas and will be designed to promote values such as India's common culture, heritage, egalitarianism, democracy and secularism, equality of sexes, protection of environment, removal of social barriers, observance of the small family norms and inculcation of scientific temper. All educational programmes will be carried on in strict conformity with secular values'. The Adult Education Programme was given a population orientation by the policy by declaring that it should be linked with a small family norm. In 1990, a committee was appointed to review the National Education Policy on Population of 1986. The Chairperson of the Committee was Dr Ramamoorthy and thus the report is often referred as the Ramamoorthy report. It recommended several modifications. It said that the population control was largely through females and so extra care should be paid to women's health, including reproductive health and sexuality, when one was empowering the women.

Revised National Policy on Population Education–1992

After the evaluation of the 1986 National Policy on Population Education, several modifications were brought out in the policy. It said that population education was to be seen as the most important factor for containing the nation's population growth. It further stated that population education should start from the first standard

onwards so that children would get an idea of the population of the country and the need for containing the population. It also stated, 'Educational programmes should actively motivate and inform youth and adults about family planning and responsible parenthood'.

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The 1992 policy laid stress on adult education. The National Literacy Mission was asked to enhance to include national goals such as alleviation of poverty, national integration, environmental conservation, observance of small family norm, promotion of women's equality, universalisation of primary education and basic healthcare. The first chapter of the 1992 Policy under the heading Education for Women's Equality stated that empowerment of women may be given priority as it will 'enable women to make informed choices in areas like education, employment and health (reproductive health).' Apart from emphasizing this, it also mentioned early childhood care and education. It said that provision should be made for maternal and child health through primary health care centres and sub centres. At the secondary level education, it stressed on six major issues which are as follows:

- Family size and family welfare
- Delayed marriage
- Responsible parenthood
- Population change and resource development
- Population related values and beliefs
- Status of women

The NCERT developed National Curriculum Framework for School Education in 2000 on population education. The following points were observed in the general objectives on population:

- Appreciation of various consequences of large families and overpopulation, and the need for checking population growth.
- Cultivating the power of understanding and an attitude towards sex-related issues and respectful attitude towards the members of the opposite sex.

Evaluation of Population Policies

Population policies and the measures taken for controlling the population in different forms gave positive results in our country. The growth rate and the fertility and mortality rate showed considerable differences. The Five-Year Plans and the implementation of the objectives of the Five-Year Plans on the population showed the way to regulate the population of our country. In 1951, India became the first country to launch the National Family Planning Programme and in 1983, a National Health Policy was adopted by the Indian Parliament. It envisaged that by the year 2000, the net reproduction rate would be Unity, with the population growth rate at 1.2 per cent birth rate of twenty-one per 1000, death rate of nine per 1000, infant

mortality rate at below sixty per 1000 live births,and couple protection rate of sixty per cent.

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Several projections and objectives were made in the context of the population which were done on the basis of population policies. The mass awareness programme was made possible through this. As a result of the population policies, targets were set-up and achieved in the following areas:

- Universalisation of primary education
- Upper limit of marriage age of girls
- Delivery aids
- Reduction in maternal mortality rate
- Universal immunization
- Reduction in infant mortality rate
- Reduction in low weight at birth
- Reduction in total fertility
- Introduction of education to the population
- Empowerment of women on aspects such as reproductive health, health and hygiene, among others.

Family Welfare Approach Services

The family welfare approach envisaged an integrated approach incorporating health, nutrition and family planning aspects while formulating population policies. Issues such as raising the age of marriage, augmenting female literacy and providing income-generating opportunities to women in order to empower them to decide about their sexuality and reproduction were considered critical components of the family welfare approach. In this respect, in 1951, the National Family Welfare Programme, a Centre-sponsored programme, was launched in India. Its foremost objective was to reduce the birth rate to such an extent so as to make the population reach a level where it can easily meet its economic demand.

The approach under Family Welfare Programme included the following:

(i) Population control and stabilisation: The Family Welfare Programme announced various family planning programmes. This was the most direct public policy measure launched to control the growth rate of population in India. The programme focussed on disseminating awareness on family planning, the use of contraceptives and other facilities. A number of sterilizations and IUD insertions were performed. The use of other contraceptive methods was also encouraged. According to the Department of Family Planning statistics, the percentage of couples effectively protected increased from 10.4 per cent in 1971 to 44.1 per cent in 1991.

In 2009, 48.4 per cent of married woman were estimated to use a contraceptive method. About three fourths of them were using sterilization method, which is considered to be the most prevalent method of birth control in India. As per the National Family Health Survey 2015-16 published in 2017, ': Modern contraceptive use by currently married women has remained unchanged, at just under 50 percent, between 2005-06 and 2015-16. Female sterilization is still the most popular contraceptive method, used by 36 percent of currently married women ... Overall, the contraceptive prevalence rate (CPR) is 54 percent of currently married women age 15-49'.

(ii) Maternal health: The Family Welfare Programme also focusses on the safety of the mother during pregnancy and childbirth. The objective of the programme is to reduce the maternal mortality rate (MMR). It has been estimated that 100,000 maternal deaths takes place in India i.e., one maternal death every five minutes. The Family Welfare Programme has launched various services and programmes for maternal health such as Antenatal Care (ANC) and the Sector Investment Programme (SIP).

The services of Antenatal Care are available in all primary health sub-centres, primary health centres, community health centres, rural family welfare centres, and district hospitals. Services for pregnant women provided under Antenatal Care include the following:

- Early registration before twelve weeks of pregnancy
- Minimum of three check-ups during pregnancy
- Administration of two doses of Tetanus Toxoid (TT)
- 100 tablets of Iron and Folic Acid (IFA)
- Counselling for nutritional diet during pregnancy
- Treatment of anaemic cases

The key motive of this service is to ensure safety and sound health of mothers during pregnancy and childbirth.

The Family Welfare Programme has launched the Sector Investment Programme (SIP) under the assistance of European Commission through Government of India with the main motive to improve the health of pregnant mothers and children and to reduce infant mortality.

Five Year Plan and National Family Welfare Programme

During the First and Second Five-Year Plans, the approach under the Family Welfare Programme was mainly 'clinical'. However, according to data released in the 1961 census, clinical approach adopted in the first two plans was replaced by an 'extension and education approach' which envisaged expansion of service facilities along with the spread of the message that a small family is the norm.

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In the Fourth Five Year-Plan, i.e., in the years 1969–74, under the Family Welfare Programme, high priority was given on the reduction of the birth rate. It was found that by the end of the plan, the birth rate came down from thirty-five per thousand to thirty-two per thousand. It was estimated that 16.5 per cent of the couples in the reproductive age group were protected against conception by the end of the Fourth Plan.

The objective under the Fifth Five-Year Plan (1974–79) was the integration of family planning services with those of maternal health, child health and nutrition. It was during this phase that a great increase in performance of sterilization was found in the country. However, it was during 1977–78 that this programme received a setback as the government stated that there is no place for compulsion or pressure in the programme and the implementation of the programme should always be an essential part of 'Family Welfare'. It was through this setback that the name of the programme was changed from Family Planning to Family Welfare.

In the Sixth Plan (1980–85), the main goal of the Family Welfare Programme was to set demographic objectives of attaining net reproduction rate of unity. This includes the lessening of birth rate, increasing the couple protection level and diminution of average size of family.

The Family Welfare Programme laid great stress on securing utmost community contribution, promoting spacing methods, and endorsing child health care and maternal care in the Seventh Five Year Plan (1985–90). It was under this plan that in 1985 the Universal Immunization Programme (UIP) was established. The establishment of the programme was mainly done to give collective coverage of pregnant women and children with immunization.

Under the Eighth Five Year Plan (1992–97), the schemes and proposals were restored and new scheme were launched. It was during this plan that much emphasis was given on the involvement of NGOs to add extra support and effort to the government programmes in inspiring the common people for adopting family planning methods and programmes. The chief objective of the Family Welfare Programme under the Ninth and Tenth Five Year Plans was to decrease the rate of population growth. Under the Ninth and Tenth Five Year Plans, the Family Welfare Programme formulated certain strategies which include the following:

- To undertake specific micro-planning in an area and easily review the requirements for child health and reproductive health.
- In order to reduce infant morbidity, maternal morbidity and mortality, the programme must offer high quality and need-based incorporated child health facilities and reproductive health services.

Appraisal of India's National Population Policy

Any public policy, including population policy, is a step towards the future and an attempt to achieve desired goals. As such, it is to be laid down in terms of goal, past and present trends towards the achievement of these goals, social condition

accounting for the direction and intensity of these trends, and projections for a probable future. This means that the population policy has to be associated with participants, values, institutions and resources.

NOTES

Generally, two types of population policies have been suggested. These are as follows:

(a) Antenatal policy, which aims at discouraging the growth of the population.
(b) Distributional policy, which deals with distributional imbalance of the population.

The National Academy of Sciences has discerned population policy as the one which influences demographic processes according to a pre-set objective which copes with the demands created by demographic processes.

As you have already studied, the Government of India adopted a population policy called the National Population Policy. This policy was launched in 1952 aiming to achieve a stable population by 2045, at a level that is consistent with the requirements of sustainable economic growth, social development and environmental protection. The aims of the National Population Policy of India are as follows:

- Decreasing birth rate
- Limiting the number of children in a family
- Decreasing mortality
- Creating awareness among the masses regarding the consequences of a rising population
- Procuring necessary contraceptives
- Enacting laws like legalizing abortion
- Checking the concentration of people in congested areas
- Providing necessary public services for effective settlement in new areas
- Relocation of offices to less populated areas

The policy was the direct result of the total size of population, a high growth rate and the problem of uneven distribution of population in rural and urban areas. The policy aimed at enhancing the quality of life and increasing individual happiness. This National Population Policy was further modified and re-announced in 1977. Education and health were reinforced in the new policy. Health included general as well as maternal and child health. Voluntary family planning was also introduced in this policy. This also saw a change of phrase from Family Planning to Family Welfare Programme.

The objectives of the National Population Policy were later appraised and it was noticed that many of the requirements for a proper population policy like requirements of contraception and health care infrastructure and health personnel had not been met. Thus, the objective of the National Population Policy 2000 was

formulated to provide integrated service to child healthcare and reproductive healthcare. The National Population Policy 2000 and its medium-term intentions were to bring the total fertility rate (TFR) to substitute levels by 2010. This was mainly achieved through strong execution of inter-sectoral operational strategies.

NOTES

Check Your Progress

1. What are the three features of a population policy?
2. What are the measures that can be taken to fulfill the objectives of a population policy?
3. What are the three main types of population policy?
4. When was the National Population Policy announced?
5. State any two goals of Population Policy.
6. When was the first National Seminar on Population Education held?
7. List four targets that were set up and achieved as a result of population policies.

5.3 NPP: OBJECTIVES AND POLICY

During the 20th century, India's population increased nearly 5 times from 23 crore to 100 crore, while during the same period world's population increased nearly 3 times from 200 crore to 600 crore.

It seems difficult to maintain a balance to conserve the resource endowment and environment in the country with 1.55 crore current annual increase in population; hence there is an urgent need to stabilize population. The basic goal of this policy is to cover various issues of maternal health, child survival and contraception and to make reproductive health care available and affordable for all.

There are three types of objectives of National Population Policy (NPP) 2000:

1. **The immediate objective:** The immediate objective of the policy was to address the unmet needs for contraception, health care infrastructure and health personnel and to provide integrated service delivery for basic reproductive and child health care.
2. **The mid-term objective:** The mid-term objective is to bring the Total Fertility Rate (TFR) to replacement level by 2010 through forceful implementation in inter-sectorial operational strategies.
3. **The long-term objective:** The long-term objective is to achieve a constant population by 2045 at a level consistent with the desires of sustainable economic growth, social development, and environment protection.

The following are the targets of National Population Policy:

- By 2045 achieve zero growth rate of population.
- To bring down infant mortality rate of below 30 per 1000 live births.
- To bring down maternal mortality ratio of below 100 per 1,00,000 live births.
- To bring down birth rate to 21 per 1000 by 2010.
- To bring down total fertility rate (TFR) to 2.1 by 2010.

National Socio-Democratic Goals 2010

To accomplish these objectives and targets, national socio-demographic goals have been framed which, in each case, are to be achieved by the year 2010.

National Socio-Demographic Goals for 2010

- Address the unmet needs for basic reproductive and child health services, supplies and infrastructure.
- Make school education up to age 14 free and compulsory, and reduce drop outs at primary and secondary school levels to below 20 per cent for both boys and girls.
- Reduce infant mortality rate to below 30 per 1000 live births.
- Reduce maternal mortality ratio to below 100 per 100,000 live births.
- Achieve universal immunization of children against all vaccine preventable diseases.
- Promote delayed marriage for girls, not earlier than age 18 and preferably after 20 years of age.
- Achieve 80 per cent institutional deliveries and 100 per cent deliveries by trained persons.
- Achieve universal access to information/counseling, and services for fertility regulation and contraception with a wide basket of choices.
- Achieve 100 per cent registration of births, deaths, marriage and pregnancy.
- Contain the spread of Acquired Immunodeficiency Syndrome (AIDS), and promote greater integration between the management of reproductive tract infections (RTI) and sexually transmitted infections (STI) and the National AIDS Control Organization.
- Prevent and control communicable diseases.
- Integrate Indian Systems of Medicine (ISM) in the provision of reproductive and child health services, and in reaching out to households.
- Promote vigorously the small family norm to achieve replacement levels of TFR.

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- Bring about convergence in implementation of related social sector programs so that family welfare becomes a people centred programme.
- Population by 2045, at a level consistent with the requirements of sustainable economic growth, social development, and environmental protection.

Did the NPP meet its targets?

The NPP had planned to change the mindset of people, when we look at the statistics, we see that the NPP 2000 failed to achieve the targets it set for 2010. The population increased to 121 crores which was many times higher than the target population projected at around 110 crores. Many theories suggest different reasons for its failure. Many say it had a very narrow perspective and concentration more crudely on contraceptive measures and sterilisation instead of more broad and sustainable poverty alleviation measures. It paid very little attention to targeting population growth through improvements in education and living standards. The other problem was the lack of infrastructure to support the stated aims. Third was the limited publicising of the policy and therefore did not gather much support and cooperation from the public.

Check Your Progress

8. List two targets of the National Population Policy.
9. List two National Socio-Demographic goals for 2010.

5.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The features of National Population Policy are:
   - It is related to all the small and big actions including laws, by-laws, acts and ordinances enacted by the government.
   - It gives the causes and effects of the population both in a quantitative and qualitative manner.
   - It studies all the groups or different sections of the population.
2. There are five ways to achieve the above objectives which are listed as follows:
   (i) Spread of Information and education
   (ii) Extension of voluntary programmes
   (iii) Change in social institution
   (iv) Provision of incentives and disincentives
   (v) Imposition of coercion

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3. There are mainly three types of population policies which are as follows:
   (i) Fertility-influencing policies
   (ii) Mortality-influencing policies
   (iii) Migration-influencing policies
4. The National Population Policy was announced in the year 1976.
5. The goals of the National Population Policy 2000 are as follows:
   - Address the unmet needs for basic reproductive and child health services, supplies and infrastructure.
   - Make school education up to age fourteen free and compulsory, and reduce drop outs at primary and secondary school levels to below twenty per cent for both boys and girls.
6. The first National Seminar on Population Education was held in 1969 and emphasised the need for population education in schools so that complete awareness on population could be initiated at the school level itself.
7. As a result of the population policies, targets were set-up and achieved in the following areas:
   - Universalisation of primary education
   - Upper limit of marriage age of girls
   - Delivery aids
   - Reduction in maternal mortality rate
8. In 1951, the National Family Welfare Programme, a Centre-sponsored programme, was launched in India. Its foremost objective was to reduce the birth rate to such an extent so as to make the population reach a level where it can easily meet its economic demand.
9. The following are the targets of National Population Policy:
   - By 2045 achieve zero growth rate of population.
   - To bring down infant mortality rate of below 30 per 1000 live births.
   - Address the unmet needs for basic reproductive and child health services, supplies and infrastructure.
   - Make school education up to age 14 free and compulsory, and reduce drop outs at primary and secondary school levels to below 20 per cent for both boys and girls.

5.5 SUMMARY

- Today, population policy has become a common feature of policy-making. There are region-specific population policies as well. Many private agencies are also engaged in designing population policies for regions and countries.

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- Even philosophers like Plato and Aristotle talked about population. Plato was in favour of a limited population to maintain quality of life. On the other hand, mercantilists were in favour of a large population as it would provide cheap labour, which was necessary for production.
- The main focus of any population policy is the welfare of the country. It aims at a balanced population so that the country continues to develop and individuals live in a satisfactory socio-economic environment.
- In India, the most important and the only component affecting the population is fertility. The other components are mortality and migration.
- After India attained freedom, high priority was given to population, its growth and its consequences on society. All the developments were related to population and each five year plan gave importance to controlling population growth. All five year plans have taken several measures to control the population.
- The National Population Policy announced in the year 1976 reiterated, 'The policy envisages a series of fundamental measures, including raising the age of marriage, female education, spread of population values and the small family norm, strengthening of research in reproductive biology and contraception, incentives for individuals, groups and communities and permitting state legislatures to enact legislations for compulsory sterilization'.
- The first National Seminar on Population Education was held in 1969 and emphasised the need for population education in schools so that complete awareness on population could be initiated at the school level itself.
- In 1986, the National Policy on Population Education was implemented. The policy gave importance to education for women and children in order to bring down the population. It emphatically said that the spread of education and literacy could be the largest single factor to reduce population growth.
- In 1990, a committee was appointed to review the National Education Policy on Population of 1986. The Chairperson of the Committee was Dr Ramamoorthy and thus the report is often referred as the Ramamoorthy report. It recommended several modifications. It said that the population control was largely through females and so extra care should be paid to women's health, including reproductive health and sexuality, when one was empowering the women.
- Revised National Policy on Population Education–1992 laid stress on adult education. The National Literacy Mission was asked to enhance to include national goals such as alleviation of poverty, national integration, environmental conservation, observance of small family norm, promotion

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of women's equality, universalisation of primary education and basic healthcare.

- The family welfare approach envisaged an integrated approach incorporating health, nutrition and family planning aspects while formulating population policies. Issues such as raising the age of marriage, augmenting female literacy and providing income-generating opportunities to women in order to empower them to decide about their sexuality and reproduction were considered critical components of the family welfare approach.
- The basic goal of National Population Policy is to cover various issues of maternal health, child survival and contraception and to make reproductive health care available and affordable for all. To accomplish these objectives and targets, national socio-demographic goals have been framed which, in each case, are to be achieved by the year 2010.

5.6 KEY WORDS

- **Migration:** Migration refers to the movement of people from one place to another location for the purpose of settling down temporarily or permanently.
- **Urbanization:** The population shift from rural areas to urban areas which leads to a decrease in the proportion of people living in rural areas is known as urbanization. It also refers to the ways in which societies adapt to this change.
- **Infant Mortality Rate:** Infant mortality rate or IMR is the number of deaths per 1,000 live births of children under one year of age.
- **Egalitarianism:** Egalitarianism is a political philosophy that stresses on the concept of social equality. It argues that all human beings are equal and deserve equal rights and opportunities

5.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. How can a country's population policy bring about social change?
2. What are the objectives of a population policy?
3. What are the goals of National Population Policy, 2000?
4. Write a short note on National Population Policy.

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Long-Answer Questions

1. Evaluate the contribution of the Five-Year Plans on India's population policy.
2. Analyse the population policies and programmes introduced in India to tackle over-population.
3. Describe the impact of Family Welfare Programmes in India.
4. Discuss the National Socio-Demographic goals for 2010.

5.8 FURTHER READINGS

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UNIT 6 POVERTY

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Structure

6.0 INTRODUCTION

A socio-economic malady, poverty, is one of the most important problems India is facing today. Poverty is a state where a person finds it unable to maintain a minimum socially accepted level of standard of living. It is regarded as the root cause for low levels of health and educational outcomes, poor access to clean water and sanitation, inadequate physical security, lack of voice, and insufficient capacity and opportunity for mobility. Poverty alleviation remained the central to all the state and central level policy making. The Five Year Plans in India had their focus directly or indirectly on reducing the poverty levels throughout the country. In India, the Planning Commission has been deciding on the methodology and making estimates of the number and percentage of poor at national and state level. These poverty estimates are treated as official. This unit provides an overview of the concept of poverty and the causes of poverty in India.

6.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the concept and types of poverty
- Examine the measurement of poverty
- Discuss the poverty line and its disadvantages

6.2 CONCEPT AND TYPES OF POVERTY

According to Mollie Orshansky, who developed the poverty measurements used by the U.S. government, 'to be poor is to be deprived of those goods and services and pleasures which others around us take for granted.' There are two types of poverty. One is income poverty and other is human poverty. Income poverty refers

to lack of necessities of material well-being. Human poverty refers to denial of opportunity for living a tolerable life. The concept and content of poverty differs from country to country. Poverty can be classified into two categories, absolute poverty and relative poverty and they are mentioned below:

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- **Absolute poverty:** Less prevalent in developed countries, absolute poverty is a state in which people do not have the minimum level of income deemed necessary for living in a civilized society. Absolute poverty refers to the percentage of populace living below the poverty line.
- **Relative poverty:** Poverty defined by reference to the living standards of the majority in any given society. Relative poverty refers to the phenomenon when the income for consumption expenditure of a section of the society is distinctively below the average income level of the society. Relative poverty indicates that a group or class of people belonging to lower income group is poorer when compared to those belonging higher income group. Since income is distributed unequally in almost all the countries, whether developed or undeveloped, relative poverty exists in every country.

Difference between Relative Poverty and Absolute Poverty

The major differences between relative and absolute poverty are given in Table 6.1.

Table 6.1 Differences between Relative and Absolute Poverty

Absolute Poverty	Relative Poverty
1. It refers to the total number of people living below poverty line. 2. The concept has relevance for less-developed countries than the developed ones. 3. In India, absolute poverty is calculated with the help of poverty line. 4. In India 21.8 per cent of the total population is absolute poor.	1. It refers to poverty of people relative to other people or regions. 2. When we say India is relatively poor, a comparison is drawn with regard to the per capita income. 3. Relative poverty is calculated with the help of Lorenz curve and Ginni Coefficient. 4. India is relatively one of the poorest countries of the world as its per capita income is less than one dollar per day.

Check Your Progress

1. Which type of countries is absolute poverty more relevant to?
2. What is relative poverty?

6.3 MEASUREMENT OF POVERTY IN INDIA

Economists have chalked out various ways of measuring poverty. The major ways by which poverty is measured are explained below.

Human Poverty Index and Multidimensional Poverty Index

People living in poverty are affected by more than only lack of income. The Multidimensional Poverty Index (MPI) complements income poverty measures by reflecting the deprivations that each poor person faces all at once with respect to education, health and other aspects of living standards. The MPI assesses poverty at the individual levels, with poor people as those, who are deprived, and the extent of their poverty being measured by the range of their deprivations.

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The MPI can be broken down to show a vivid picture of people living in poverty, both across countries, regions and the world and within countries by ethnic group, urban/rural location, or other key household characteristics. It is the first international measure of its kind, and offers a valuable complement to income poverty measures because it measures deprivations directly. The MPI can be used as an analytical tool to identify the most vulnerable people, show aspects in which they are deprived and help to reveal the interconnections among deprivations. This enables policymakers to target resources and design policies more effectively. Other dimensions of interest, such as work, safety, and empowerment, could be incorporated into the MPI in the future, as data become available. The Oxford Poverty and Human Development Initiative (OPHI) is currently conducting research to collect and analyse internationally comparable data on these 'missing dimensions' of poverty.

On 7 December 2011, a new analysis was released which shows MPI poverty at the sub-national level for sixty-six countries and tracks changes to MPI poverty over time in ten countries.

An international measure of poverty for 109 developing countries, the MPI complements income-based poverty measures by reflecting the multiple deprivations that people face at the same time. The MPI identifies deprivations across health, education and living standards, and shows the number of people who are multi-dimensionally poor and the deprivations that they face at the household level. It uses ten indicators across three dimensions, as the diagram below shows.

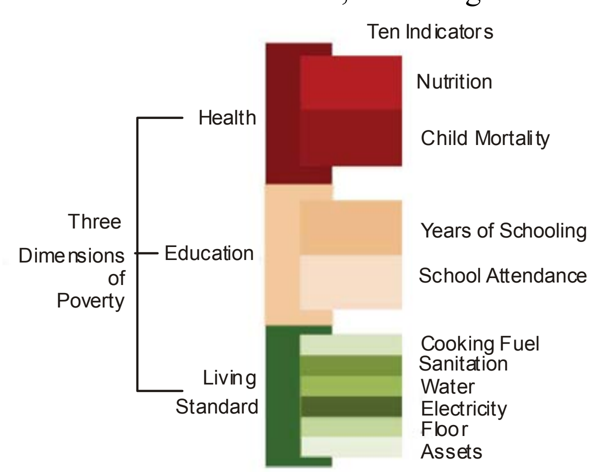


Figure. 6.1 Indicators and Dimensions of MPI

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The MPI uses ten indicators to measure three critical dimensions of poverty at the individual level: education, health and living standard in 109 developing countries. These directly measure deprivations in health and educational outcomes as well as key services such as water, sanitation, and electricity reveal not only how many people are poor but also the composition of their individual poverty. The MPI also reflects the intensity of poverty—the sum of weighted deprivations that each person faces at the same time. A person, who is deprived of 70 per cent of the indicators, is clearly worse off than someone who is deprived in 40 per cent of the indicators.

What is new for 2011?

Introduced in 2010, the MPI now covers 109 developing countries nationally and the HDR functions at the sub-national level. The researchers at OPHI carried out an analysis, which inferred the following conclusions:

In 2011, the MPI has been calculated for five new countries and updated for twenty countries. The MPI has been calculated for sub-national regions across sixty-six countries.

Changes of MPI over time have been analysed for ten countries and their regions.

The MPI is robust to a range of plausible weights and poverty cut-offs.

The MPI is an international poverty measure, developed by the OPHI for the United Nations Development Programme's flagship Human Development Report (HDR). The innovative index reflects the multiple deprivations that a poor person faces with respect to education, health and living standards.

The HDR 2010 measured poverty in terms of a new parameter, namely, multidimensional poverty index (MPI), which replaced the human poverty index (HPI) used since 1997. The Human Poverty Index used country averages to reflect aggregate deprivations in health, education, and standards of living. The MPI indicates the share of the population that is multi-dimensionally poor, adjusted by the intensity of deprivation in terms of living standards, health, and education. According to this parameter, India has a multidimensional poverty index of 0.123 and Population living below income poverty line, PPP $1.90 a day (%) was 21.2 per cent.

In 2012, the former Planning Commission constituted a new expert panel on poverty estimation, chaired by C Rangarajan with the following key objectives: (i) to provide an alternate method to estimate poverty levels and examine whether poverty lines should be fixed solely in terms of a consumption basket or if other criteria are also relevant; (ii) to examine divergence between the consumption estimates based on the NSSO methodology and those emerging from the National Accounts aggregates; (iii) to review international poverty estimation methods and indicate whether based on these, a particular method for empirical poverty estimation can be developed in India, and (iv) to recommend how these estimates

of poverty can be linked to eligibility and entitlements under the various schemes of the Government of India. The Committee is expected to submitted its report in 2014.

> 'As per the report submitted by Mr. Rangarajan to Planning Minister Rao Inderjit Singh earlier, persons spending below Rs 47 a day in cities would be considered poor, much above the Rs 33—per—day mark suggested by the Suresh Tendulkar Committee.
>
> As per Rangarajan panel estimates, a person spending less than Rs 1,407 a month (Rs 47/day) would be considered poor in cities, as against the Tendulkar Committee's suggestion of Rs 1,000 a month (Rs 33/day).
>
> In villages, those spending less than Rs 972 a month (Rs 32/day) would be considered poor. This is much higher than Rs 816 a month (Rs 27/day) recommended by Tendulkar Committee.
>
> In absolute terms, the number of poor in India stood at 36.3 crore in 2011—12, down from 45.4 crore in 2009—10, as per the Mr. Rangarajan panel. Tendulkar Committee, however, had suggested that the number of poor was 35.4 crore in 2009—10 and 26.9 crore in 2011—12.'

6.3.1 Poverty Line and Disadvantages

Poverty line is a level of personal income defining the state of poverty. This concept is very frequently used by economists to measure the extent of poverty in a country. In order to find out the extent of poverty and measure the number of poor people in the country, the economists use the concept of poverty line. Poverty line has been defined as a level of personal or family income below which one is classified as poor according to governmental standards. Poverty line can be identified through the following steps:

(i) Poverty line is identified in terms of a minimum nutritional level of food energy required for subsistence. This minimum nutritional level of food energy is expressed in terms of minimum daily intake of calories. The Planning Commission of India has defined the poverty line in terms of nutritional requirement of 2,400 calories per person per day for rural areas and 2,100 calories per person per day in the urban areas.

(ii) Poverty line is also identified in terms of per capita consumption expenditure required to get minimum calorie intake. Thus, poverty line is set at the level of consumption expenditure per person required for the minimum calorie intake.

The percentage of populace which falls below poverty line are identified as the underprivileged. Head Count Ratio calculates the extent of poverty in India. This method measures the number of poor as the proportion of people living below poverty line. This was mentioned in the previous section.

Disadvantages

Albeit a deprived person's basic needs are for food, clothing and shelter. The poverty line is often contested for not reflecting the socio-economic needs including statistics on healthcare, education, etc.

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Another problem with the poverty line estimates is determining the components of the poverty line basket. The price differentials keep on changing along with the consumption pattern, price of the components, the nutritional needs, etc., making it difficult to compute and really reflect the true conditions.

Poverty line estimates are considered to be a skewed understanding for targeting development of the most deprived. There are also certain questions related to how poverty line is determined. There are arguments for both income based and consumption based calculations.

The following were the key findings of the 2019 Global Multidimensional Poverty Index (MPI) data and publication "Illuminating Inequalities" released on 11 July 2019**:**

- Across 101 countries, 1.3 billion people—23.1 percent—are multidimensionally poor.
- Two-thirds of multidimensionally poor people live in middle-income countries.
- There is massive variation in multidimensional poverty within countries. For example, Uganda's national multidimensional poverty rate (55.1 percent) is similar to the Sub-Saharan Africa average (57.5 percent), but the incidence of multidimensional poverty in Uganda's provinces ranges from 6.0 percent to 96.3 percent, a range similar to that of national multidimensional poverty rates in Sub-Saharan Africa (6.3–91.9 percent).
- Half of the 1.3 billion multidimensionally poor people are children under age 18. A third are children under age 10.
- This year's spotlight on child poverty in South Asia reveals considerable diversity. While 10.7 percent of South Asian girls are out of school and live in a multidimensionally poor household, that average hides variation: in Afghanistan 44.0 percent do.
- In South Asia 22.7 percent of children under age 5 experience intrahousehold inequality in deprivation in nutrition (where at least one child in the household is malnourished and at least one child in the household is not). In Pakistan over a third of children under age 5 experience such intrahousehold inequality.
- Of 10 selected countries for which changes over time were analysed, India and Cambodia reduced their MPI values the fastest—and they did not leave the poorest groups behind.
- There is wide variation across countries in inequality among multidimensionally poor people—that is, in the intensity of poverty experienced by each poor person. For example, Egypt and Paraguay have similar MPI values, but inequality among multidimensionally poor people is considerably higher in Paraguay.
- There is little or no association between economic inequality (measured using the Gini coefficient) and the MPI value.

- In the 10 selected countries for which changes over time were analysed, deprivations declined faster among the poorest 40 percent of the population than among the total population.

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Head Count Poverty Index

The Planning Commission, which is the nodal agency for estimating the number and proportion of people living below the poverty line at national and regional levels, separately for rural and urban areas; makes poverty estimates every five years. The survey is based on a large sample survey of household consumption expenditure carried out by the National Sample Survey Organization (NSSO) after an interval of approximately five years. The Commission has been estimating the poverty line and poverty ratio since 1997 on the basis of the methodology spelt out in the report of the Expert Group on 'Estimation of Number and Proportion of Poor' (known as Lakdawala Committee Report). On the basis of NSS 61st Round (July 2004 to June 2005) consumer expenditure data, the poverty ratio is estimated at 28.3 per cent in rural areas, 25.7 per cent in urban areas, and 27.5 per cent for the country as a whole in 2004–05 using uniform recall period (URP). In URP, consumer expenditure data for all the items are collected for a 30-day recall period. Based on mixed recall period (MRP) for the same period, the poverty ratios are 21.8 per cent in rural areas, 21.7 per cent in urban areas, and 21.8 per cent for the country as a whole. In MRP, consumer expenditure data for five non-food items, namely clothing, footwear, durable goods, education, and institutional medical expenses, are collected for a 365-day recall period and the consumption data for the remaining items are collected for a 30-day recall period. The poverty estimate in 2004–05 based on URP consumption (27.5) is comparable to that of 1993–94 (36). The poverty estimates in 2004–05 based on MRP consumption (about 21.8) is roughly (but not strictly) comparable to that of 1999–2000 (26.1). Table 6.2 shows the comparable poverty estimates based on the URP and MRP methods. Poverty ratio for rural India is considerably higher than the poverty ratio for urban areas on the basis of URP while it is almost the same on the basis of MRP.

Table 6.2 Comparable Poverty Estimates Based on URP and MRP Methods

Poverty Ratios by URP and MRP(per cent)			
S. No.	**Category**	**Years**	
	By URP Method (uniform recall period)	**1993–94**	**2004–05**
1	Rural	37.3	28.3
2	Urban	32.4	25.7
3	**All India**	36.0	27.5
	By MRP Method (mixed recall period)	**1999–94**	**2004–05**
4	Rural	27.1	21.8
5	Urban	23.1	21.7
6	**All India**	26.1	21.8

Source: Government of India, Economic Survey, 2007–08

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Poverty Gap Index

The poverty gap (PG) is defined as the average difference between poor households' expenditure and the poverty line. The gap is considered to be zero for everyone else. The poverty gap is the average, over all people, of the gaps between poor people's living standards and the poverty line. It indicates the average extent to which individuals fall below the poverty line (if they do). The poverty gap index expresses the poverty gap as a percentage of the poverty line.

The poverty gap thus, measures the transfer that would bring the income of every poor person exactly up to the poverty line, thereby eliminating the poverty. In this way, the poverty gap reflects the depth of poverty, as well as its incidence. However, the poverty gap index is insensitive to the extent of inequality among the poor. If income is transferred from a poor person to someone who is poorer, the poverty gap index will not change. This limitation notwithstanding, the poverty gap measure is definitely superior to simple head count index and it is this reason why of late it is in common use.

Estimates of Poverty Gap index

Ozler, Datt and Ravallion have compiled these estimates for the Poverty and Human Resources Division of the World Bank. These estimates explain that from 1950–51 to 1973–74 there was no long-term time trend, but thereafter there was a steady decline in the Poverty Gap Index till 1989–90. In 1990s, this trend was reserved and in July 1995 to December, 1997, the Poverty Gap Index was 8.21 for rural population and 7.27 for the urban population.

(iv) Squared Poverty Gap Index

The Squared Poverty Gap Index is defined as the mean of the squared proportionate poverty gaps. This measure reflects the severity of poverty as it is sensitive to inequality amongst the poor. The squared poverty gap index is a weighted sum of poverty gaps (as a proportion of the poverty line), where the weights are the proportionate poverty gaps themselves such as the PG, but with weights given to each observation. No doubt, income poverty is the best measure for squared poverty gap index.

Ozler, Gaurav Datt and Ravallion have provided estimates for squared poverty gap. These estimates show that until 1973–74 the severity of poverty had not declined as compared to 1950–51. However, since 1973–74 there is a sharp decline in squared gap index for both urban and rural population. For rural population, the squared poverty gap index in 1997 was 2.76 as against 7.13 in 1973–74. Similarly, for urban population, the squared poverty gap index declined from 5.22 in 1973–74 to 2.73 in 1999.

Check Your Progress

3. How does multi-dimensional poverty vary within countries?
4. Define poverty gap.

6.4 REASONS FOR POVERTY IN INDIA AND SUGGESTIONS TO ALLEVIATE IT

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There are several reasons responsible for poverty in India. Some of them are discussed below:

(i) **Growth of population:** One of the major problems of poverty in India is the high growth rate of population especially among the poor. This is because of their strong belief in traditions, illiteracy and also their preference for the male child, which results in increase in population. With limited income, and numerous mouths to feed, they are unable to make ends meet.

(ii) **Low rate of economic development:** Low rate of economic development is another major cause of poverty. The rate of economic development in India has been below the required level. It implies low per capita income, leading to a low standard of living. The population in India has been increasing at an annual average rate over 2 per cent during the plan period. Employment opportunities increase slowly because of low growth rate in the economy. This has kept the poor families in the state of poverty.

(iii) **Unemployment:** With more than 2 crores unemployed people (in 2003–2004), India is in the grip of unemployment and underemployment. There is less job opportunities compared to the number of job seekers. Efforts have been made to promote small and cottage industries to generate employment; however, even these industries could not absorb sufficient workforce so as to reduce poverty. Thus, the problem of unemployment and indebtedness is responsible for making the problem of poverty more acute.

(iv) **Lack of education:** Growth of population has long been associated with the lack of education. Since the poor have limited access to education, they usually end up with low-paid jobs. This in turn, results in low income. Since, most underprivileged people are illiterate; they think that more the number of members in the family, more it will help in acquiring wealth.

(v) **Inflationary pressure:** The constant rise in price has only added to the miseries of the poor. Sharp rise in prices has led to fall in the real income of fixed and low-income earners. Because of this, the poor reduced their purchasing power. This in turn, has led to low standard of living.

(vi) **Socio-cultural factors:** Socio-cultural set-up of the country also contributes to poverty to a large extent. Usually, people belonging to lower castes and tribal groups, comprise the poor. Illiteracy and limited chances of mobility perpetuates poverty. Factors such as caste system, joint family system, religious faith and beliefs, and law of inheritance have hindered the process of economic growth.

(vii) **Growth strategy:** Various strategies designed in the government plans have not been implemented properly. Some are yet to be developed. In fact, the

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growth strategy has kept the poor out of the development process. Prof. H. Meghnad Desai points out, 'India's poverty–creating programmes is larger than its poverty removal programme.'

(viii) **Inequalities in income:** Inequalities of income in rural and urban areas of the country is another cause of poverty. During the plan period, a large proportion of increased income has been cornered by the affluent ones. Due to inequalities in the distribution of income and assets, even a small rise in per capita income could not affect the poor. Hence, the problem of poverty has become acute.

(ix) **Inadequate anti-poverty measures:** In view of the large magnitude of the problem of poverty in the country, the anti-poverty measures taken by the government are far from adequate. Some of them have been implemented half-heartedly and the ones, which have been implemented, have benefited only selected sections of the populace. Despite implementation of measures, the success in alleviating poverty has been limited.

(x) **Capital deficiency:** Capital formation is a very important factor that can lead to economic growth and fall in poverty. There is a dearth of capital in India which results in low productivity, low per capita income and the end result happens to be poverty.

(xi) **Globalization:** Globalization has pushed many households below poverty line. It is because production of some of the most important food crops have declined as agricultural land is being used for production of export crops after the inception of the globalization process. Liberalization has also forced small farmers to compete in a global market where prices of agricultural good are low.

(xii) **Political factors:** Political structure of the country is also one of the factors accounting for the continued poverty. Political power is concentrated in the hands of the upper strata of the society, both in the urban area and rural areas. Economic policies are formulated to promote the interest of the richer section of the society. Poor people, particularly peasants, landless labourers, tribal people and slum dwellers suffer in the process.

Poverty Reduction Strategies

For the most underdeveloped nations of the world, bank's assistance plans are based on poverty reduction strategies. The method implemented was by combining a cross-section of local groups with an extensive analysis of the country's financial and economic situation; the World Bank developed a strategy pertaining uniquely to the country in question. The government then identifies the country's priorities and targets for the reduction of poverty, and the World Bank aligns its aid efforts correspondingly.

Forty-five countries pledged US$25.1 billion in 'aid for the world's poorest countries', which goes to the International Development Association (IDA), an

association of the World Bank. This in turn is distributed among eighty poor countries in the form of loans. While wealthier nations sometimes fund their own aid projects, including those for diseases, and although IDA is the recipient of criticism, Robert B. Zoellick, the president of the World Bank, said when the loans were announced on 15 December 2007, that IDA money 'is the core funding that the poorest developing countries rely on'.

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Despite implementing all the strategies, India currently adds forty million people to its middle class every year. Analysts such as the founder of Forecasting International, Marvin J. Cetron writes that an estimated 300 million Indians now belong to the middle class; one-third of them have emerged from poverty in the last ten years. At the current rate of growth, a majority of Indians will be middle-class by 2025.

Despite government initiatives, corporate social responsibility (CSR) remains low on the agenda of the corporate sector. Only 10 per cent of funding comes from individuals and corporate, and 'a large part of CSR initiatives are artfully masqueraded and make it back to the balance sheet'. The widening income gap between the rich and the poor over the years has raised fears of a social backlash.

Check Your Progress

5. List any two reasons for poverty in India.
6. How can capital formation lead to economic growth and fall in poverty?

6.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A socio-economic malady, poverty, is one of the most important problems India is facing today.
2. Relative poverty refers to the phenomenon when the income for consumption expenditure of a section of the society is distinctively below the average income level of the society.
3. Multi-dimensional poverty within countries varies greatly. Nepal is poorer according to the MPI than Cambodia, but Cambodia's poorest region is poorer than the poorest region of Nepal.
4. The poverty gap is defined as the average difference between poor household's expenditure and the poverty line.
5. The two reasons for poverty in India are mentioned below:
    - Growth of population
    - Low rate of economic development
6. Capital formation is a very important factor that can lead to economic growth and fall in poverty. There is a dearth of capital in India which results in low productivity, low per capita income and the end result happens to be poverty.

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6.6 SUMMARY

- According to Mollie Orshansky, who developed the poverty measurements used by the U.S. government, 'to be poor is to be deprived of those goods and services and pleasures which others around us take for granted.'
- The concept and content of poverty differs from country to country. Poverty in India has been defined as that situation, in which an individual fails to earn enough to buy the minimum means of subsistence. These include satisfactory level of nutritional diet, minimum required clothing, housing and minimum level of health facilities such as clean water and so on.
- People living in poverty are affected by more than only lack of income. The Multidimensional Poverty Index (MPI) complements income poverty measures by reflecting the deprivations that each poor person faces all at once with respect to education, health and other aspects of living standards.
- An international measure of poverty for 109 developing countries, the MPI complements income-based poverty measures by reflecting the multiple deprivations that people face at the same time. The MPI identifies deprivations across health, education and living standards, and shows the number of people who are multi-dimensionally poor and the deprivations that they face at the household level.
- The HDR 2010 measured poverty in terms of a new parameter, namely, multidimensional poverty index (MPI), which replaced the human poverty index (HPI) used since 1997. The MPI indicates the share of the population that is multi-dimensionally poor, adjusted by the intensity of deprivation in terms of living standards, health, and education.
- The Planning Commission, which is the nodal agency for estimating the number and proportion of people living below the poverty line at national and regional levels, separately for rural and urban areas; makes poverty estimates every five years.
- The survey is based on a large sample survey of household consumption expenditure carried out by the National Sample Survey Organization (NSSO) after an interval of approximately five years. The Commission has been estimating the poverty line and poverty ratio since 1997 on the basis of the methodology spelt out in the report of the Expert Group on 'Estimation of Number and Proportion of Poor' (known as Lakdawala Committee Report).
- The poverty gap (PG) is defined as the average difference between poor households' expenditure and the poverty line. The gap is considered to be zero for everyone else. The poverty gap is the average, over all people, of the gaps between poor people's living standards and the poverty line. It indicates the average extent to which individuals fall below the poverty line (if they do).

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- The Squared Poverty Gap Index is defined as the mean of the squared proportionate poverty gaps. This measure reflects the severity of poverty as it is sensitive to inequality amongst the poor. The squared poverty gap index is a weighted sum of poverty gaps (as a proportion of the poverty line), where the weights are the proportionate poverty gaps themselves such as the PG, but with weights given to each observation.
- One of the major problems of poverty in India is the high growth rate of population especially among the poor. This is because of their strong belief in traditions, illiteracy and also their preference for the male child, which results in increase in population. With limited income, and numerous mouths to feed, they are unable to make ends meet.
- The constant rise in price has only added to the miseries of the poor. Sharp rise in prices has led to fall in the real income of fixed and low-income earners. Because of this, the poor reduced their purchasing power. This in turn, has led to low standard of living.
- Various strategies designed in the government plans have not been implemented properly. Some are yet to be developed. In fact, the growth strategy has kept the poor out of the development process. Prof H. Meghnad Desai points out, 'India's poverty–creating programmes is larger than its poverty removal programme.'
- Capital formation is a very important factor that can lead to economic growth and fall in poverty. There is a dearth of capital in India which results in low productivity, low per capita income and the end result happens to be poverty.
- Globalization has pushed many households below poverty line. It is because production of some of the most important food crops have declined as agricultural land is being used for production of export crops after the inception of the globalization process. Liberalization has also forced small farmers to compete in a global market where prices of agricultural good are low.
- Forty-five countries pledged US$25.1 billion in 'aid for the world's poorest countries', that goes to the International Development Association (IDA) an association of the World Bank. This in turn is distributed among eighty poor countries in the form of loans.
- Despite government initiatives, corporate social responsibility (CSR) remains low on the agenda of the corporate sector. Only 10 per cent of funding comes from individuals and corporate, and 'a large part of CSR initiatives are artfully masqueraded and make it back to the balance sheet'. The widening income gap between the rich and the poor over the years has raised fears of a social backlash.

6.7 KEY WORDS

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- **Absolute poverty:** It refers to the percentage of populace living below the poverty line.
- **Relative poverty:** It refers to the phenomenon when the income for consumption expenditure of a section of the society is distinctively below the average income level of the society.
- **Poverty gap:** It is defined as the average difference between poor households' expenditure and the poverty line.
- **Squared Poverty Gap Index:** It is defined as the mean of the squared proportionate poverty gaps.

6.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on poverty in India.
2. What is the difference between relative and absolute poverty?
3. What are the indicators used by the MPI to measure poverty?
4. Write a short note on Uniform Recall Period (URP) and Mixed Recall Period (MRP)

Long-Answer Questions

1. Analyse Human Poverty Index as an important tool for measuring poverty.
2. Assess the estimation of the multi-dimension poverty index.
3. Critically evaluate the causes of poverty in India.
4. Analyse the various poverty reduction strategies.

6.9 FURTHER READINGS

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UNIT 7 SOCIAL WELFARE PROGRAMMES

Structure

7.0 INTRODUCTION

In this unit, you will learn about the necessity of social welfare in a country. There is a need to evaluate the programmes and policies introduced in India in order to understand its effectiveness and implementation. The unit will also delve into the policies and programmes adopted for poverty alleviation in India. Poverty and unemployment are two plaguing issues in India which go hand-in-hand. The causes, types and effects of unemployment have been discussed in detail. Furthermore, the unit will delve into the policies and programmes adopted by the Indian government to address the conditions of the workers in the country.

7.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain Recollect some of the social welfare schemes in India
- Analyse the programmes and policies introduced for poverty alleviation in India
- Describe the types and causes of unemployment in India
- Evaluate the policies adopted to tackle unemployment in India

7.2 SOCIAL WELFARE IN INDIA

The schemes of the Ministry of Social Justice and Empowerment are meant for the weaker sections of society, including women.

Table 7.1 Social Welfare Schemes In the Country as on 2019

NOTES

Sl. No.	Programme/Schemes
	Schemes for Scheduled Caste (SC)
1.	Pre Matric Scholarship for SCs
2.	Post Matric Scholarship for SCs
3.	Free Coaching for SCs and Other Backward Classes (OBCs)
4.	Pradhan Mantri Adarsh Gram Yojana
5.	Strengthening of machinery for Enforcement of Protection of Civil Right Act 1955 and Prevention of Atrocities Act, 1989
6.	Babu Jagjivan Ram Chhatrawas Yojna for Boys
7.	Babu Jagjivan Ram Chhatrawas Yojna for Girls
8.	Assistance to Voluntary Organisations. for SCs
9.	Pre-matric Scholarships for the children of those engaged in unclean occupation
10.	Special Central Assistance to Scheduled Castes Sub Plan
11.	National Fellowship for SCs
12.	Self Employment Scheme of Liberation & Rehabilitation of Scavengers
13.	National Overseas Scholarship for SCs
14.	Top Class Education for SCs
15.	Assistance to Scheduled Castes Development Corporations (SCDCs)
16.	National Scheduled Castes Finance and Development Corporation
17.	National Safai Karmachari Finance and Development Corporation
18.	Venture Capital Funds for SCs
19.	Credit Enhancement Guarantee Scheme for SCs
	Schemes for Backward Classes (OBCs)
20.	Pre-Matric Scholarship for OBCs students
21.	Post-Matric Scholarship for OBCs students
22.	Construction of Hostel for OBC Boys and Girls
23.	Dr. Ambedkar Scheme of Interest Subsidy on Educational Loan for Overseas Studies for OBCs/EBCs
24.	Assistance for Skill Development of OBCs/EBCs/DNTs
25.	National Fellowship for OBCs
26.	Dr. Ambedkar Post-Matric Scholarship for EBC students
27.	Scheme for Development of Denotified, Nomadic and Semi-nomadic Tribes (DNTs) (Scholarship of Pre+Post Matric+ Nanaji Deshmukh Hostel)
28.	National Backward Classes Development Corporation
	Schemes for Senior Citizen and Prevention of Alcoholism and Drug Abuse
29.	Rashtriya Vayoshri Yojna
30.	Scheme for prevention of Alcoholism and Substance (Drugs) Abuse.
	Scheme for the Persons with Disabilities
31.	Assistance to Disabled Persons for purchase/Fitting of Aids and Appliances (ADIP) Scheme
32.	Scholarship for Students with Disabilities

Check Your Progress

1. For whom are the social welfare schemes of the Ministry of Social Justice and Empowerment targeted?
2. Name two welfare schemes for disabled persons in India.

7.3 POLICIES FOR POVERTY ALLEVIATION

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The problem of poverty—a multidimensional challenge for India—needs to be addressed seriously. Poverty alleviation and improvement in the standard of living of the masses has been one of the most important objectives of planning in India. However, the emphasis that is laid on the objective of poverty alleviation and the strategy to achieve this objective has changed over the years. The measures which have been adopted by the government for the removal of poverty are as follows:

(i) **Economic growth:** Economic growth can be helpful in removing poverty because of the trickle-down effect. It was thought that the benefits of economic growth would trickle down to the underprivileged in the form of more employment and more income because of the expansion of agricultural and non-agricultural activities. There are several potential drivers of growth. These drivers include the impact of economic growth, development of a dynamic private sector, good management skills, etc.

(ii) **Population control:** High growth rate of population among the lower strata of the society is an important factor that is responsible for the perpetuating problem of poverty. Jansankhya Sthirata Kosh (JSK) has been registered as an autonomous society of the Ministry of Health and Family Welfare. The Government has provided a ₹100 crore Corpus fund to signify its commitment to the activities of the Kosh. JSK has to use the interest on the Corpus and also raise contributions from organizations and individuals that support population stabilization.

(iii) **Agricultural development:** Along with a substantial increase in plan allocation and credit for agriculture proper, an ambitious Bharat Nirman for rural infrastructure, the National Rural Employment Guarantee Act (MGNREGA) to dovetail employment security with land and water conservation, and the Backward Regions Grants Funds (BRGF) have enabled Panchayati Raj institutions in poorer regions to make their own plans. In addition to enhancing the scope of these initiatives, and making modifications as suggested by the various working groups, the Eleventh Plan introduced the Rashtriya Krishi Vikas Yojana(RKVY). This put in effect the NDC resolution to 'introduce a new scheme for Additional Central Assistance to incentivize states to draw up plans for the agricultural sector more comprehensively, taking agro-climatic conditions, natural resource issues and technology into account, and integrating livestock, poultry and fisheries more fully.'

(iv) **Land reforms:** The Government had worked on a combined Land Acquisition and Rehabilitation & Resettlement Bill, 2011. The reason for combining the two into a single legislation is that land acquisition and resettlement and rehabilitation (R&R) need to be seen necessarily as two sides of the same coin. The Bill which is now an Act seeks to balance the

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need for facilitating land acquisition for various public purposes, including infrastructure development, industrialization and urbanization, while at the same time meaningfully addressing the concerns of farmers and those whose livelihoods are dependent on the land being acquired.

(v) **Development of cottage and small-scale industries:** The small-scale industries have been given a special place in the industrialization programme. Since these industries have played an important role in the generation of employment and in ensuring a more equitable distribution of income; the government has provided necessary incentives, support technical assistance and infrastructure facilities to promote these industries.

(vi) **Public Distribution System:** The government has also launched a scheme of Public Distribution System (PDS). The objective of this scheme is to provide cheap and subsidized food grains to the poor. The PDS functions through a wide network of fair price shops. Since June 1997, a new scheme known as the Targeted Public Distribution System (TPDS) has been adopted in order to provide subsidized food grains for the families falling below the officially estimated poverty line at the rate of 10 kgs per month per family.

The government is considering the National Food Security Bill, 2013. According to this Bill, every person belonging to 'priority households' are entitled to receive five kilograms of food grains per person per month at subsidized prices from the state government under the TDPS. The TPDS system today supports over 40 crore Indians below the poverty line with monthly supply of subsidized food grains. The system also provides gainful employment for 4.78 lakh Fair Price Shops Owners, their employees and hired labour who work at the FCI and state warehousing godowns.

Since the Fifth Five Year Plan (1974–79), poverty alleviation has been adopted as an explicit objective of our economic planning. Since then, a number of poverty alleviation programmes have been launched with the specific objective of reducing poverty. During the 1970s, a number of special programmes for the rural poor were undertaken. Some of the important programmes were as follows:

- Small Farmers Development Agency (SFDA)
- Marginal Farmers and Agricultural Labourers Development Agency (MFALDA)
- Drought-Prone Area Programme (DPAP)
- Crash Scheme for Rural Employment (CSRE)

The wage employment programmes started as pilot projects in the form of Rural Manpower Programme (RMP) [1960-61], Crash Scheme for Rural Employment (CRSE) [1971–72], Drought Prone Area Programme started as Rural work Programme (RWP) [1972], Small Farmers Development Agency (SFDA), Marginal Farmers & Agricultural Labour Scheme (MF&AL) for the poorest of the poor. These experiments were translated into a full-fledged wage-

employment programme in 1977 in the form of Food for Work Programme (FWP). In the 1980s, this programme was further streamlined into the National Rural Employment Programme (NREP) and Rural Landless Employment Guarantee Programme (RLEGP), JawaharRozgarYojana (JRY1993–94) and Employment Assurance Scheme (EAS). This programme (RLEGP) begun in 1983.

In the 1980s and 1990s, the government undertook various programmes which were more comprehensive and made a direct attack on rural and urban poverty. The important programmes were as follows:

- National Rural Employment Programme (NREP)
- Rural Landless and Employment Generation Programme (RLEGP)
- Jawahar Rozgar Yojna (JRY)
- Integrated Rural Development Programme (IRDP)
- Scheme of Training Rural Youth for Self-Employment (TRYSEM)
- Self-Employment Programme for Urban Poor (SEPUP)
- Nehru Rozgar Yojna (NRY)

These special poverty alleviation programmes have been revamped, redesigned and restructured to make these programmes more effective. The important poverty alleviation programmes in operation in rural and urban areas are explained as follows:

(i) **National Social Assistance Programme (NSAP):** The National Social Assistance Programme (NSAP) which came into effect from 15 August 1995, represents a significant step towards the fulfillment of the Directive Principles in Article 41 of the Constitution. The programme introduced a National Policy for Social Assistance for the poor and aimed at ensuring minimum national standards for social assistance in addition to the benefits that the states are currently providing or might provide in future. NSAP at present, comprises the following:

  - **Indira Gandhi National Old Age Pension Scheme (NOAPS):** Under this scheme, helpless aged person of more than sixty years of age gets financial assistance of between ₹ 200 to ₹ 1000 depending on the State Contribution.
  - **Indira Gandhi National Family Benefit Scheme (NFBS):** Under this scheme, the family living below poverty line receives a lump-sum central grant in case of death of the primary bread earner in the family.
  - **Indira Gandhi National Maternity Benefit Scheme (NMBS):** Under this scheme, a pregnant woman of more than nineteen years of age from a family living below poverty line gets assistance for maternity care.

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- **Annapurna Scheme:** A food security scheme for destitute under NSAP who are not covered under NOAPS.
- **Indira Gandhi National Disability Pension Scheme:** It is a scheme to provide spectful life financial assistance are provided to severe and multi-disabled persons who are living below poverty line.
- **Indira Gandhi National Widow Pension Scheme (IGNWPS):** For widows below poverty line in the age group of 40-59 years.

(ii) **Indira Awaas Yojana (IAY):** It is an important scheme whose main purpose is the construction of houses for the poor people. Initially, it aimed at providing houses free of cost to the poor families belonging to scheduled castes and scheduled tribes and free bonded labourers. Later, the scheme was extended to cover other underprivileged categories as well.

(iii) **Shiksha Sahayog Yojana (SSY):** This scheme was launched on 31 December 2001. It aims at providing monthly education allowance of ₹ 600 for children whose parents meet the criteria of living below the poverty from the ninth to twelfth standard.

(iv) **Pradhan Mantri Gramodaya Yojana (PMGY):** PMGY was introduced in 2000–01 with the objective of focussing on village level development in five critical areas such as health, primary education, drinking water, housing and rural roads. PMGY includes the following three major projects:

- **Pradhan Mantri Gram Sadak Yojana (PMGSY):**PMGSY was launched on 25 December with the objective of providing road connectivity through good all-weather roads to all rural habitations.
- **Pradhan Mantri Gramodaya Yojana (GraminAwaas):** This scheme was implemented in April 2000 based on Indira AwaasYojana having at its heart the aim of sustainable habitat development in rural areas to accommodate the increasing housing needs of the poor people living in villages.
- **Pradhan Mantri Gramodaya Yojana (Rural Drinking Water Project):** Rural Drinking Water Project was launched with the objective of developing projects for providing water harvesting, water conservation and drinking water to drought prone areas.

(v) **Samagra Awaas Yojana (SAY):** This scheme was undertaken in 1999–2000 on pilot project basis to meet the housing needs in one block in each twenty-five districts of twenty-four states and in one Union Territory with a view to ensuring integrated provision of shelter, sanitation and drinking water.

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(vi) **Natural Food for Work Programme (NFWP):** This programme was initially launched in February 2001 for five months, and was further extended. The programme aims at augmenting food security through wage employment in the drought affected areas in eight states, namely, Gujarat, Chhattisgarh, Himachal Pradesh, Madhya Pradesh, Maharashtra, Orissa, Rajasthan and Uttarakhand. Under this scheme, wages are paid partly in kinds like food grains and partially in cash. It is the responsibility of the state governments to implement this scheme.

(vii) **Krishi Shramik Samajik Suraksha Yojana (KSSSY):** KSSSY came into effect in July 2001 with an aim to provide social security benefit to agricultural labourers, who were between the age of 18 and 60 years.

(viii) **Annapurna:** The Annapurna Scheme became effective from April 2000 as an entirely Centrally Sponsored Scheme. The main purpose of this scheme was to provide food security to meet the needs of senior citizens. The scheme became effective in most Indian states and five Union Territories. This scheme offered assistance to more than 6,08,000 families.

(ix) **Jawaharlal Nehru National Urban Renewal Mission (JNNURM):** This scheme was launched in 2005–06 for a seven-year period. It has two components—Basic Service to the Urban Poor Programmes (BSUPP) and Integrated Housing and Slum Development programme (IHSDP).

(x) **Valmiki Ambedkar Awaas Yojana (VAAY):** This scheme was launched in the year 2001. It facilitates the construction and upgradation of dwelling units for slum dwellers. It also provides community toilets under Nirmal Bharat Abhiyan.

(xi) **Antodaya Anna Yojana (AAY):** With the sole aim of offering food security to the senior citizens under the National Old Age Pension Scheme, food grains are given to the beneficiaries at subsidized rates of ₹ 2 per kg. This scheme became effective from 1 April 2000 as an entirely Centrally Sponsored Scheme. It has covered more than 6,00,000 people. As announced in the Union Budget 2005–06, the AAY was further expanded to cover 50 lakh below poverty line households, which extends its coverage to 2.5 crore households.

(xii) **Garibi Hatao:** 'Garibi hatao', which means 'eradicate poverty' was the slogan of the Sixth Five Year Plan of the Indira Gandhi Government. Agricultural growth became the focus of the government and a number of poverty alleviation schemes were undertaken.

(xiii) **Food for work programme**: A short run programme was initially launched with effect from February 2001 for five months, but it was further extended. The main objective of this programme was to augment

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food security by making available wage employment in the drought affected rural areas in eight states, namely, Gujarat, Chhattisgarh, Himachal Pradesh, Madhya Pradesh, Maharashtra, Orissa, Rajasthan and Uttaranchal. The Central Government is responsible for making available a sufficient amount of food grains for free to each of the states that was affected by the drought. Wages by the State government can be paid partially in kind (up to 5 kg of food grains per Monday) and partially in cash. Assuring the notified minimum wages, the workers are paid the minimum balance of wages in cash. This programme stood extended up to 31 March 2002 in respect of notified 'National Calamity Affected Districts'. This scheme was later merged in NREGS since 2 February 2006.

DeendayalAntyodayaYojana – National Rural Livelihoods Mission (DAY-NRLM): It is one of the flagship programmes of the Ministry of Rural Development, Government of India to alleviate rural poverty. The programme aims to organize the rural poor women into their own institutions like Self Help Groups and their federations, Producers' Collectives etc. and also ensure their financial inclusion and livelihoods support. Since its launch in 2011, the Mission has spread to 4456 Blocks of 584 Districts, across 29 States and 5 Union Territories.

Poverty in India: Social Dimensions

Poverty is more of social marginalization of an individual, household or group in the society rather than an inadequacy of income to fulfill the basic needs. It is obvious that insufficient income is an important factor of marginalization. However, it is not the sole factor of marginalization. The connections between ignorance and poverty and ill health and poverty are deep-rooted. Diseases like malaria, tuberculosis, diarrhoea and malnutrition, which are common in India, are caused largely due to poverty. When the poor fall ill due to poverty, they do not have the resources to seek quality healthcare, and hence have to borrow money for treatment. There are innumerable instances of indebtedness due to hospitalization. Poverty, thus, is an intricate phenomenon of different dimensions rather than just the economic dimension. Hence, any programme for poverty alleviation should address the issue of poverty from broader social and economic perspectives.

We cannot deny the importance of education and health in our life. Together, they form the fundamental rights of all citizens of the world. An investment in these two sectors is certain to result in the reduction of poverty. Education and health are central to a meaningful life. Also, it is through their labour that the poor can mobilize themselves socially. Labour is an asset for the poor that lends itself to improvement.

But bad health leads to poverty, and poverty leads to further deterioration of health. Illness makes the poor more susceptible to diseases and disabilities. The poor do not have any access to financial markets and information. They also find

it difficult to exercise their rights and organize themselves. They are marginalized and are relegated outside the formal sector of the economy. They are more vulnerable to fraud and other exploitative practices. Often, they are underpaid for their work and are offered little or no security under the labour laws.

Even corruption seems to hit the poor harder. The government offers several welfare schemes to the poor, which mostly remain unavailed because of the prevalence of corruption among public servants, politicians and bureaucrats.

It is the government's responsibility to deal with social, cultural and economic discrimination and inequalities. But social welfare schemes cannot be formulated and implemented without the alliance of the government, NGOs and the corporate sector. These alliances should have representation from the underprivileged sections, too. Social security measures should aim at creating an egalitarian society based on equal opportunities for people belonging to different classes, regions, castes and genders.

An emphasis on democratic values of the Indian subcontinent and human rights is essential for addressing the problem of poverty. Pluralism must be recognized as an important element that can create sustainable social conditions in the country. This is so because social inequalities gnaw at our social framework. Thus, all factors should be taken into account before poverty reduction schemes are undertaken.

Check Your Progress

3. What is the objective of Public Distribution System (PDS)?
4. What was the objective of Pradhan Mantri Gramodaya Yojana?
5. What was the main purpose of Annapurna Scheme?

7.4 UNEMPLOYMENT

One of the most acute challenges that the Indian economy has been facing is the mounting rate of unemployment. It promotes poverty and inequalities, lowers social standards and is a huge loss of manpower resources to the nation. Unemployment is a chronic malady in India that deprives able bodied people to work on the current wages. It lowers the standard of living of the people since unemployed people do not have enough purchasing power. They face social degradation and suffer from inferiority complex. Therefore, some economists call unemployment problem as a socio-economic challenge to the society.

Unemployment is becoming a serious problem in India, though accurate estimate is difficult to obtain. About seven million people are added to the labour force every year and the number is also increasing at faster rate. But on the contrary, the economy growth is not creating enough jobs.

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The number of unemployment in India increased from 2.01 crore in 1993–94 to 2.66 crore in 1999–2000. The labour force in 1999–2000 was about 363.33 million (36.33 crore) which has gone up significantly during Tenth Plan period. According to the data released by the NSSO, employment on Current Daily Status (CDS) basing during the periods 1999–2000 and 2004–05, had increased considerably in comparison to the augmentation registered during the periods 1993–94 and 1999–2000. During this period, about 47 million work opportunities were created compared to only 24 million in the period between 1993–94 and 1999–2000. Employment growth accelerated from 1.25 per cent per annum to 2.62 per cent per annum. However, the labour force grew at faster rate of 2.84 per cent than the work force, and unemployment force also rose. The incidence on unemployment on CDS basis increased from 7.31 per cent in 1999–2000 to 8.28 per cent in 2004–05.

Employment growth in the organized sector, public and private combined declined during the period 1994–2007. This can be attributed to the increase in employment rate in the public organized sector.

The compound annual unemployment growth rate in the organized sector, including public and private sectors in the country during 2008 to 2011 was 1.72 per cent. It was –0.24 for the public sector and 5.06 for the private sector.

Changes in 2018-19

Until June 2012, the NSSO used to present unemployment or labour related data based on **quinquennial household socio-economic survey programme. In 2017, the Periodic Labour Force Survey was constituted with** two major objectives for measurement of employment and unemployment. The first was to measure the dynamics in labour force participation and employment status in the short time interval of three months for only the urban areas in the Current Weekly Status (CWS). Secondly, for both rural and urban areas, to measure the labour force estimates on key parameters in both usual status (ps+ss) and CWS.

Key Findings of the 2018-19 PLFS

India's unemployment rate fell to 5.8% during 2018-19 from 6.1% during the same period of 2017-18. The labour force participation rate rose to 37.5% during 2018-19 from 36.9% of 2017-18. The female participation rate also improved going up to 18.6% in 2018-19 from 17.5% the year before. The worker population ratio also increased, to 35.3% as against 34.7% in the 2017-18.

Unemployment and Underemployment: Definitions

Unemployment is defined as a situation wherein able bodied persons fail to find a job even though they are willing to work at the prevailing wage rate. Unemployment is a two-fold phenomenon:

- An individual is not currently employed

- He/She is ready to work at the prevailing wage rates
- An individual must make an effort to find work

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According to the Bureau of Labour Statistics, USA, the unemployed include people who do not have a job, have actively looked for work in the past four weeks, and are currently available for work. Also, people who were temporarily laid off and are waiting to be called back to that job are included in the unemployment statistics. In another sense, workers are considered to be the producer of services and when they are unable to sell their services, they are said to be unemployed. Underemployment, however, refers to a situation when a worker does not work for full hours (normally 8 hours a day). It is again the under-exploitation of manpower resources of the country. The Indian agriculture sector is facing such unemployment.

Extent of Unemployment in Developing Countries

It should, however, be mentioned that the problem of unemployment and underemployment represents a challenge to the developing countries just as the problem of cyclical unemployment is a challenge to the countries where advanced industrial development has taken place. The major problems of employment in the developing countries have been conceived of as follows:

- The provision of productive work for the farm population during long periods of seasonal unemployment has not been addressed properly.
- The prevention of the annual increase in employable population from further aggravating the situation of chronic underemployment and disguised unemployment in agriculture—which in many parts of these countries have already reached the point of saturation—has not been taken seriously. This occurs in urban areas also.
- The Indian planning has not paid any attention to manpower planning. It had always concentrated on the development of agriculture and industry. The eradication of unemployment has never been the prime objective of any plan.
- The Indian education system produces simple graduates and postgraduates and not professionals. It has never matched the needs of the economy. Our education system is neither job-oriented nor skill-oriented.
- Overpopulated countries like India need to stress upon the development of cottage and small-scale industries because it needs less capital and low technical skills. But the lack of communication and knowledge creates hurdles in its performance.
- The Indian agriculture absorbs the excessive pressure of overpopulation resulting into disguised unemployment. From each family farm, if we withdraw one or two members, the total productivity will not be affected, but at the same time, alternative job opportunities must be made available which unfortunately does not happen.

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- The Indian labour is attached with their families and native places. They do not move far off to search a job and source of their livelihood.
- Illiteracy creates unskilled labour. Skilled and trained labour is required in modern industries. Thus, the illiterate and unskilled labourers remain unemployed in the country.

Types of Unemployment

The following are the various kinds of unemployment that have been prevalent in our country. These points also talk about the causes of each type.

(i) **Voluntary unemployment:** Those people are known to be voluntarily unemployed who are not working by choice. They do not avail of an employment opportunity because they consider such a job as below their dignity. Besides, there are countless reasons of voluntary unemployment, but higher education is one of the major causes of being voluntarily unemployed in India.

(ii) **Disguised unemployment:** Disguised unemployment means that the number of workers employed in a job is much more than are actually required. It is invisible in nature since even if some workers are withdrawn from the work, the total production remains unchanged. Technically, disguised unemployment or invisible employment exists when marginal productivity of a labour is zero. Suppose five workers are engaged on a work, if two of them are withdrawn from it and the total work remains unaffected, the two persons are disguisedly unemployed.

It arises in India due to the following reasons:

- Increasing pressure of population on land
- Lack of alternative employment opportunities
- Involvement of more and more people in agriculture since it is a family occupation

The concept of disguised unemployment was introduced by Professor Ragnar Nurkse who claims that such kind of unemployment is very harmful for the nation and directly affects its overall productivity. It is the hidden unemployment which keeps underdeveloped country like India in a vicious circle of poverty. Disguised unemployment exists mostly in rural India thus keeping low productivity of this sector. It keeps the Indian farmers on subsistence level living.

(iii) **Open unemployment:** Open unemployment is said to prevail when all the unemployed have no work to do even though they are willing to work on the prevailing wages. It is mostly found in cities and industries. Such kind of unemployment is often categorized in the following forms:

- *Cyclical unemployment*: Cyclical unemployment arises due to the cyclical activities in a capitalist system. Cyclical activities are found in

different economic phases: boom, recession, depression and recovery. The phases of depression and recession throw many people out of job, which results into cyclical unemployment. The investment activities get discouraged and entrepreneurs cut down their level of production. The demand for labour declines and mass unemployment occurs. Such unemployment is generally found in the industrial sector in a free economy. Due to small industrial sector, this type of unemployment is not found in India.

- *Structural unemployment*: Structural unemployment arises due to the changes in demand pattern and supply structure. With the passage of time, when the demand pattern of goods changes, there will be a change in the demand pattern for labour. Some labours in one sector become idle, while there may be demand in the other sector. Since labour cannot immediately switch over to the new pattern, it causes structural unemployment. This type of unemployment is mostly found in underdeveloped countries like India. It is because of this reason that the rate of capital formation is low in these economies and the desired rapid industrialization is not possible. As a result, a vast labour force remains unemployed.
- *Frictional unemployment*: The kind of unemployment which arises due to imperfections of labour market is known as frictional unemployment. It arises due to the movement of labour from one industry to another or from one place to another. It means that there are jobs and job seekers in the economy, but unemployment arises due to rigidities and frictions in the economy. It is of temporary nature and vanishes with the removal of market imperfections.

(iv) **Seasonal unemployment:** When unemployment arises due to changes in season, it is termed as seasonal unemployment. It is found in agricultural sector and seasonal industries. Agriculture in India is a seasonal occupation. Labourers find work for five to seven months a year, i.e., during the sowing and harvesting season. They remain unemployed for the remaining period, known to be the victims of seasonal unemployment. Such unemployment is also found in sugar mills, rice mills, ice factories and cracker industries where work is limited only for a few months.

(v) **Technological unemployment:** When unemployment arises due to change in technology, it is known as technological unemployment. In this situation, the workers are put to superior technology, which is labour saving and time saving. It throws some workers out of job, as a surplus labour.

(vi) **Educated unemployment:** When unemployment arises due to the expansion of educational facilities at school and university level, it is known as educated unemployment.

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This form of unemployment is seen to exist among professionals as well as people holding general educational degrees. However, this type of unemployment is very dangerous because it can bring revolutionary changes in the political sector. Figure 7.1 illustrates the broad causes of unemployment.

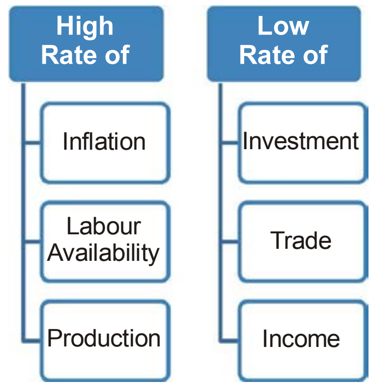


Figure. 7.1 Broad Causes of Unemployment

(vii) **Agricultural unemployment:** Unemployment in the agriculture sector is termed as agricultural unemployment.

(viii) **Industrial unemployment:** Unemployment in the industrial sector is termed as industrial unemployment.

Reasons, Effects and Measures for Unemployment in India

The various reasons for the unemployment in India are mentioned below:

- **Voluntary unemployment:** People who take voluntary unemployment do not avail of an employment opportunity, because they consider such a job as below their dignity. Sometimes, people prefer remaining idle over availing low wage unemployment.
- **Disguised unemployment:** It is invisible in nature since even if some workers are withdrawn from the work, the total production remains unchanged. Technically, disguised unemployment or invisible unemployment exists when marginal productivity of a labour is zero.
- **Cyclical unemployment:** It arises due to the cyclical activities in a capitalist system.
- **Structural unemployment:** It arises due to the changes in demand pattern and supply structure.
- **Frictional unemployment:** It arises due to imperfections of labour market.
- **Seasonal unemployment:** This arises due to change in season, it is termed as seasonal unemployment.
- **Technological unemployment:** It arises due to change in technology.

- **Educated unemployment:** It arises due to the following reasons:
  - o Expansion of education facilities
  - o Educational system is not job oriented
  - o Educated persons consider many jobs to be beneath themselves
- **Agricultural unemployment:** It can be attributed to a number of reasons. The farmer can remain employed only for some parts of the year; the farms can no longer employ the available hands; the villages lack subsidiary industries and the vagaries of monsoons and weather conditions increase the rate of agricultural unemployment, etc.
- **Industrial unemployment:** It takes place due to the high population rate in comparison with employment opportunities in the industry, uneconomic and non-geographic distribution of industries, conditions of depression and recession, etc.

Effects of Unemployment

The following is a list of the outcomes of unemployment:

- The gravest problem that the unemployed have to face is the lack of financial resources. They find it difficult to make ends meet. This directly impacts their standard of living.
- They might find it difficult to pay their economic obligations such as home loans, car loans and insurance premiums, or even house rent. This can lead them to become homeless.
- One of the related problems in underemployment. Unemployment may force people to undertake jobs that are not in accordance with their skills, experience and education qualifications.
- Unemployed people have to undergo psychological angst and anxiety. Generally, they will suffer too much stress, and so, they might resort to drugs and alcohol.
- Unemployment is a hindrance to social progress. It relegates people to lower status than they have been in the habit of enjoying.

Measures for Unemployment in India

The following measures are suggested in this regard:

(i) **Increase in the rate of economic growth:** It is believed that higher economic growth rate will lead to larger production and thereby larger increase in employment. Therefore, the government should plan to introduce labour intensive technique of production which should give more emphasis on those levels of production which have high potential of employment opportunities.

NOTES

(ii) High rate of capital formation: The rate of capital formation must be increased in India. Capital formation should encouraged only in those areas which generate greater employment opportunities. Presently, this rate is 30 per cent of the GDP, but it needs to be raised to the level of 30 per cent to 35 per cent.

(iii) Education reforms: The Indian education system should be made more employment oriented. From the very beginning, emphasis should be laid on vocational education.

(iv) More expansion of employment exchange: Employment exchanges are the institutions that bring together jobs and jobs seekers. More employment exchanges will make the labour more mobile. However, there is a need to improve the functioning of employment exchanges in the country.

(v) Policy towards seasonal unemployment: Indian agriculture is of a seasonal nature, due to which the Indian farmers remain unemployed for some time. The employment policy in India should act in the following direction to remove these problems:

- Promotion of multiple cropping
- Promotion of activities allied to agriculture
- Investment programmes for rural areas
- Setting up of seasonal industries

(vi) Policy towards seasonal unemployment: Nearly, 62 per cent people are self-employed in India, and most of them are engaged in agriculture sector. The government should provide different facilities and encouragement to the people who are engaged in their own occupations.

(vii) Employment opportunities for women: Presently, 12 per cent of women are employed in organized sector, which is a quite low percentage. The Government of India should take the following steps to promote women employment:

- Residential accommodation for working women on a large scale
- Education and training facilities for working mothers
- Availability of crèches for the children of working mother

(viii) Promotion of co-operative industry: The industries in cooperative sector should be encouraged. It requires lesser investment for the promotion of employment.

(ix) Encouragement to small-scale units: Small-scale units can provide more employment opportunities for men and women. There is a need of lesser skill and training in such units. The government should encourage such units by offering them special incentives.

(x) **Special employment programmes:** The government should introduce special programmes for poor people, Schedule Caste and Schedule Tribes, landless labourers and unemployed women. These programmes should be centrally sponsored and properly monitored.

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7.4.1 Various Programmes and Policies of Employment

Demographic changes resulting in a growing proportion of economically active younger population, throws a major challenge as well as an opportunity for the economy. The trade off between capital intensive (higher productivity) and labour intensive (employment generating) techniques adds to the complexities. Simultaneously, the problems of child labour and gender bias in the labour market continue to bother. Labour and employment issues in our economy cannot be seen in isolation. On the contrary, they are closely connected to the issues of income and poverty levels and overall developmental policies. The population explosion has caused unemployment to become a perennial problem in India. Employment generation and labour protection have hence been overriding goals for the nation.

Labour force in the non-agricultural sector can be divided into three different segments. At one hand, there are the elite white-collar workers, consisting of senior public sector officials and the managerial class in the private sector; on the other end are self-employed, informal-sector workers and casual labourers making up the unorganized sector. In between the two, follows the regular wage employees in the public sector and in the organized private sector, who account for about 7 per cent of the labour force, about 22 million people. There are about 408 million people employed in India, out of which, 232 million (56.8 per cent) are self-employed, total of 175 million wage earners (43.2 per cent). According to the NSSO (2004–05) 61st round, around 395 million workers (86 per cent) out of the total workforce of around 457 million workers constitute the unorganized/ informal sector. According to the 1991 census, the number of working children in the country was of the order of 12 million. Two-thirds of India's workforce finds employment in agriculture and rural industries. One-third of rural households are agricultural labour households, subsisting on wage employment. Only about 9 per cent of India's workforce is in the organized sector; the remaining 91 per cent are in the unorganized sector, self-employed, or employed as casual wage labourers. To a large extent, this reflects the high share of agriculture in the workforce, as well as the low growth in manufacturing employment. Within the organized sector, the public sector accounts for about two-thirds of the employment.

Despite the ambitious industrialization programme undertaken in 1950, there has been only a modest decline in the agricultural sector's share of the workforce (from 71.2 per cent to 66.8 per cent). Organized-Sector labour, which is highly unionized, has managed to achieve significant growth in real wages, much ahead of the growth of per capita income in the economy. Such a trend contradicts the

NOTES

rhetoric of reducing income disparity and providing greater increases in income to the lower-income groups. Large industries managed to absorb these higher wages, because the markets were protected from world competition through trade restrictions and the firms could pass on the higher costs to consumers. The declining employment elasticity can be attributed to employers investing in more capital-intensive technologies, and the considerable amount of labour shedding in the private and public sector enterprises since the mid-1980s (Bhattacherjee, 1999).

Modifying labour laws to enhance flexibility in labour markets was envisaged as part of the economic reform program that commenced in 1991. However, the lack of consensus and political instability at the centre has delayed the passage of industrial relations reforms. A handful of changes have been initiated in recent years. For instance, as part of the restructuring of unprofitable public-sector enterprises, the government to reduce their workforce instituted a voluntary retirement scheme (assisted by the National Renewal Fund). This, in turn, triggered similar programs in the private sector.

In India, employment in manufacturing grew at an average annual rate of 1.83 per cent while real wages grew at an average annual rate of 1.12 per cent. The Indian manufacturing sector is characterized by a significant presence of small scale and unregistered manufacturing—it accounts for 24 per cent of the capital employed and 82 per cent of the workforce. In the last two decades, the registered manufacturing sector has witnessed an investment boom. As a result, this investment boom, employment growth in registered manufacturing, improved in the 1990s, accelerating to approximately 3.7 per cent. However, there seems to be no association between growth in earnings and employment across industries. The share of wages in value added has changed over the years for the manufacturing sector. After structural reform in 13 out of the 28 industries, the share of wages fell by more than 10 per cent. In unregistered manufacturing, growth rates of employment, output, and investment have slowed after the reforms. Poor employment growth and a sharp fall in the number of establishments have adversely affected unregistered manufacturing (Nagaraj, 2002). A recent study estimated that in 1997, India could have had more than 1 million more jobs in the textiles and clothing sector alone if its labour regulations had been less restrictive. Overall, the country could have had 2.8 million more good quality formal sector jobs—a startling 45 per cent of existing employment in the organized manufacturing sector on that date.

Regulations and Rigidities

The agrarian and the informal sectors of the economy, which account for the bulk of employment, have remained outside the scope of labour laws and labour-market institutions. The few laws applicable to the unorganized sector (including agriculture) are difficult to administer and enforce owing to the decentralized nature and geographic dispersion of these activities. Furthermore, the informal nature of employment contracts, the illiteracy of the workers, and the surplus labour in the

rural economy have doomed attempts to unionize these workers. Most labour laws in India are therefore applicable to the organized sector. While the organized sector employs only a small proportion of the labour force in the country, slow growth of employment in the sector has economy-wide repercussions.

Legislative Framework

There are as many as 165 labour legislations including 47 central acts. Some of the laws are described in the subsequent paragraphs.

- **Factories Act of 1948:** The Factories Act of 1948 is the fundamental labour law in the organized sector and is mandated for all factories. It aims to regulate working conditions in factories and ensures minimum standards of safety, health, and welfare conditions of factory workers. The act also regulates the working hours, leave, holiday, overtime, and employment of children, women, and young persons.
- **Minimum Wages Act, 1948:** The Minimum Wage Act is an Act to provide for fixed minimum rates of wages in employments. A minimum wage is the lowest hourly, daily or monthly remuneration that employers may legally pay to workers. The Minimum Wages Act, 1948 is one of the pillars of legal regulation of work in India. It is also a prime instrument for ensuring adequate income and living standards among workers in general and those in unorganized sector, in particular. The Act mandates both the Central and State Governments as appropriate Governments to fix, review, revise and enforce minimum wages in the scheduled employments under their respective jurisdiction. Currently, there are 45 scheduled employments in the Central sphere and as many as 1628 scheduled employments in the State sphere. The Central Government introduced a National Floor Level Minimum Wage in 1996 and has revised it from time to time on the basis of increase in consumer price index for industrial workers. The National Floor Level Minimum Wage, which is non-statutory, is presently fixed at ‘ 100 per day. In India, minimum wages are declared at national, regional, sectoral and occupational or skill level. Minimum wages in India is declared on daily, hourly, and monthly basis. Government, employer and trade union representatives are normally involved for setting the minimum wages. Minimum wages in India has both fixed and variable component.
- **Shops and Establishments Act:** The Shops and Establishments Act regulates the working conditions of workers in the unorganized sector, including shops and establishments that do not fall under the Factories Act.
- **Industrial Disputes Act of 1947:** Employment security in India is regulated mainly on the basis of the Industrial Disputes Act of 1947. The Industrial Disputes Act (IDA) of 1947 governs the relationship between the worker and her employer. This act applies to establishments employing 50 or more workers in the organized sector. Because of the pressures from trade unions,

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the IDA itself was amended in 1976 and 1982. According to the 1976 amendment of the IDA, any firm employing 300 more workers requires permission from the government before laying off or retrenching its workers. The 1982 amendment of the IDA made this provision applicable to all firms employing 100 more workers. These populist amendments led to further employment inflexibility since government permission to lay off workers was seldom forthcoming.

In 2002, the government decided to amend the Industrial Disputes Act of 1947 allowing companies to lay off employees without seeking its permission, if they employ less than 1,000 workers. This change is likely to affect 95 per cent of Indian enterprises. The amendments also stipulated that an employer had to give three weeks' notice in writing to the worker of any change in his working conditions.

- **Industrial Employment (Standing Orders) Act:** This Act sets the rights and obligations of employees and employers relating to classification of employees, hours of work, entry and exit, attendance, stoppage of work, leave and holidays, punishments for misconduct, suspension or dismissal, separation on retirement, grievances, redress procedures, and so on. This is mandatory in industrial establishments employing 100 or more employees. Standing Orders regulate job security by specifying classification of employee categories; they regulate income security through provisions on computation of payments for hours worked and leave; and they regulate employment security through restrictions on punitive terminations and prescribed procedures for taking disciplinary action in cases of misconduct. The overall effect is that the employers are left with very little non-negotiated authority to transfer workers from one job to another or from one location to another.
- **Contract Labour (Regulation and Abolition) Act, 1970:** The Contract Labour (Regulation and Abolition) Act, 1970 was enacted to protect and safeguard the interests of contract workers. It applies to every establishment/ contractor in which 20 or more workers are employed. It also applies to establishments of the Government and local authorities. Every establishment and contractor, to whom the Act applies, has to register it/obtain a license for execution of the contract work. The interests of contract workers are protected in terms of wages, hours of work, welfare, health and social security. The amenities to be provided to contract labour include canteen, rest rooms, first aid facilities and other basic necessities at the work place like drinking water and so on. The responsibility to ensure payment of wages and other benefits is primarily that of the contractor, and, in case of default, that of the principal employer.
- **Workers' Welfare Funds:** The Ministry of Labour and Employment is administering five Welfare Funds for beedi workers, non-coal mine workers and cine workers. The Funds have been set up under the following Acts of

Parliament for the welfare of these workers:

- o The Mica Mines Labour Welfare Fund Act, 1946
- o The Limestone and Dolomite Mines Labour Welfare Fund Act, 1972
- o The Iron Ore, Manganese Ore and Chrome Ore Mines Labour Welfare Fund Act, 1976
- o The Beedi Workers Welfare Fund Act, 1976
- o The Cine Workers Welfare Fund Act, 1981

The Acts enable the Central Government to meet the expenditure incurred in connection with measures and facilities, which are necessary or expedient to promote the welfare of such workers. In order to give effect to the objectives laid down in the above Acts, various welfare schemes have been formulated and are under operation in the fields of health, social security, education, housing, recreation, and water supply and so on.

- **Trade Union Act of 1926:** The Trade Union Act provides for the registration and operation of the trade unions. The act allows any seven workers to register their trade union, but has no provision for union recognition (e.g., through a secret ballot procedure). This has led to a multiplicity of unions with outsiders playing a prominent role. In 1996, India had 58,805 registered unions, the vast majority of which were small unions that depend on their affiliates at the national labour centres to do their bargaining. In many cases, the outsiders controlling the unions are not concerned about the genuine interests of the organization and workers— they misguide workers and use them to pursue their own agenda. The large number of trade unions (affiliated to various political parties) has also led to inter union rivalry for members. This rivalry manifests itself in labour militancy. From 1950 to 1975 almost 30 per cent of the industrial disputes in India could be attributed the problems of union recognition and inter union rivalry (Datta Chaudhuri, 1996). Since the 1980s, decentralized bargaining and independent trade unionism have become more important. The number of plant-based independent and unaffiliated trade unions has risen, which may have caused a decline in the power of centralized affiliated unions, especially in the private sector (Bhattacherjee, 1999). Most of the employers do not want trade union activities in their company and the workers involved in trade union activities are victimized and harassed.
- **Trade Union (Amendment) Act, 2001:** Parliament has passed Trade Union Amendment Bill, 2000. The bill was introduced with objectives: (i) to control multiplicity of Trade Unions (ii) establishing industrial democracy (iii) encourage well-managed expansion of trade unions. The amendment Act was introduced after incorporating the recommendation of Ranajujam Committee. The Act has following important provisions:

- o Minimum 10 per cent of the total labour force of 100 labour in an organization mush be required to form trade union
- o Annual contribution for trade union should not be less than ‘ 12.00
- o Number of members should not be less than seven in any condition
- o At least five members or one-third should be the employees of the concern

Labour Market Reforms

The Indian government has been working effectively in order to bring about major reforms in the labour market and make it more worker-friendly. The major reforms in the labour market are explained in the subsequent sections.

(a) Exit Policy

The introduction of reforms in India and the consequent liberalisation of the economy has exposed the entrepreneurs to an ever increasing competition. Since then, several policy measures have been undertaken by the Government in order to enhance the global competitiveness of the Indian companies. One of the important sets of policy measures relates to reforms in the labour sector. But the most contentious issue in this sector which still remains unaddressed is that of the exit policy. This is because the companies have been arguing for a flexible exit policy while the labour unions have been against such a step because of their fear of loss of job security. But a liberal policy towards the entry and expansion of firms would be beneficial only if it is accompanied with a rational policy towards the exit of unviable firms. It is a necessary condition for inducing competition and enhancing the efficiency of resource use.

The term ‘exit’ is the obverse of the term ‘entry’ into industry. It refers to the right or ability of an industrial unit to withdraw from or leave an industry or in other words to close down. The proposal to introduce an exit policy was first mooted in 1991 when it was felt that without labour market flexibility, efficient industrialization would be difficult to achieve. The need for such a policy arises as a result of modernization, technology upgradation, restructuring as well as closure of industrial units. Such a policy will allow employers to shift workers from one unit to another and also retrench excess labour. In India, the Industrial Disputes Act, 1947 puts restrictions on employers in the matter of reducing excess staff by retrenchment, by closure of establishments and the retrenchment process involved lot of legalities and complex procedures. Also, any plans of retrenchment and reduction of staff and workforce are subjected to strong opposition by trade unions.

The key consideration in evolving a practical industrial exit policy is the protection of the legitimate interests of workers, both in the public and the private sector. Hence, the Government policy has been that if a unit can be made economically viable by restructuring it and retraining/redeploying the labour, no efforts should be spared to do this. Only in the case of units where even restructuring would not render it economically viable should the option of closure of the unit be

allowed. Even here, to minimize the adverse effects of closure of a unit on labour, several options like social security nets, insurance schemes and other employee benefit schemes as well as creation of a fund to pay retrenchment benefits to employees have been in place.

NOTES

(b) Retrenchment through Voluntary Retirement Scheme (VRS)

Most of the public sector undertakings are overstaffed; the government initiated a Voluntary Retirement Scheme (VRS) in 1988 to help them to lay off excess numbers and to improve the age mix and skill mix. It was introduced as an alternative legal solution to solve this problem. It is the most humane technique to provide overall reduction in the existing strength of the employees. It is a technique used by companies for trimming the workforce employed in the industrial unit. It is now a common method used to dispense off the excess workforce and thus improve the performance of the organisation. It is a generous, tax-free severance payment to persuade the employees to retire from the company voluntarily. It is also known as 'Golden Handshake' as it is the golden route to retrenchment. VRS allows employers including those in the government undertakings, to offer voluntary retirement schemes to off-load the surplus workforce and thus no pressure is put on any employee to exit.

Since then, many companies in large corporate sector the public sector have opted for retrenchment of labour through the announcement of VRS. Public sector Banks have also seen the exit of more than one lakh employees through the VRS route. The public sector enterprises have resorted to still larger job cuts through the VRS route.

A business firm may opt for a voluntary retirement scheme under the following circumstances:

- Due to recession in the business
- Due to intense competition, the establishment becomes unviable unless downsizing is resorted to
- Due to joint ventures with foreign collaborations
- Due to takeovers and mergers
- Due to obsolescence of product/technology

Companies are turning lean and mean to increase their profit margins. Because of the increasing threat from competition, the domestic companies are now focusing more on core competence and less on diversification. They are accordingly trying to pull out of unrelated and unprofitable business.

Companies also adopt VRS when they form strategic alliances with other companies or there is a takeover. Unfortunate workers are the victim of the process of consolidation, restructuring, mergers, acquisition and amalgamation, which is sweeping the Indian corporate sector presently. As a result of liberalization, many Multi-National Corporations (MNCs) have entered in the industrial sector during

the last few years. In MNCs, the production process in a unit carried out with a handful of workers because these companies used automatic machines and employ labour saving technologies. This can lead to the displacement of hundreds of workers previously employed in the unit.

NOTES

(c) National Renewal Fund

The structural adjustment and industrial restructuring programme is bound to have serious implication for the labour class and result in large-scale retrenchments. In order to protect the interest of workers, the Government of India created a National Renewal Fund (NRF) in February 1992. The main objectives of NRF were as follows:

- To provide funds for employment generation scheme in the organized and unorganized sector in order to provide social safety net for labour
- To provide funds for compensation to employees affected by restructuring or closures of industrial units both in public and private sectors
- To provide assistance to firms to cover the costs of retaining and redeployment of employees arising as a result of modernization and technological upgradation of existing capacities and from industrial restructuring

Components of NRF

National Renewal Fund (NRF) had three components:

(i) **The Employment Generation Fund (EGF):** The Employment Generation Fund(EGF) was meant to provide resources for employment generation schemes in both the organized and unorganized sectors.

(ii) **The National Renewal Grant Fund (NRGF):** The National Renewal Grant Fund(NRGF) was meant to deal with payments under the VRS programme and compensation to workers affected by closure/ rationalization resulting from approved rehabilitation schemes in both the public and private sector enterprises.

(iii) **The Insurance Fund for Employees:** The Insurance Fund for Employees (IFE) was expected to cater to the compensation needs of the employees in future.

The only component of the NRF that was operational was NRGF. While the main objective of NRF was to help in training counselling and redeployment of affected workers and also employment generation. The main criticism against the NRF is that it remained a fund for financing VRS solely in the Central Public Sector undertakings though this fund was dissolved, but the Government has been continuously making efforts in this direction.

(d) Scheme of Counselling, Retraining and Redeployment (CRR) of Rationalized Employees of Central Public Sector Undertakings (CPSUs)

The objective and scope of the scheme is to provide opportunities of counselling, retraining and redeployment to the rationalized employees of Central Public Sector Enterprises (CPSEs) rendered redundant as a result of modernization, technology upgradation and manpower restructuring in the CPSEs. It consists of three main elements:

- **Counselling:** Counselling is the basic pre-requisite of the rehabilitation programme of the displaced employees. The displaced employees need psychological counselling to absorb the trauma suffered by them due to loss of job and the resulting challenges both for himself and for the members of his family. He needs to be made aware of the new market opportunities so that he may, depending upon his aptitude and expertise, take up suitable economic activities.
- **Retraining:** The process of retraining helps employees in rehabilitation. The trainees are helped in acquiring necessary skills/expertise/orientation to start new activities and re-enter the productive process after loss of their jobs.
- **Redeployment:** Redeployment of such rationalized employees in the production process through the counselling and retraining efforts. At the end of the programme, they should be able to engage themselves in alternate vocations of self-employment. Whereas there cannot be any guarantee that the rationalized employee will be assured of alternative employment, yet possible help from the identified nodal training agencies as well as from the concerned Central Public Sector Undertakings (CPSUs) would be extended to them for starting new avocations.

The scheme was introduced by the Department of Public Enterprises (DPEs) and has been assigned the responsibility of implementing the scheme through its Counselling, Retraining and Redeployment (CRR) Cell. For carrying out various activities for implementation of the CRR Scheme, many nodal training agencies have been set up which have several Employees Assistance Centres located all over the country to meet the training needs under the Scheme.

Displacement of a large number of workers through the mechanism of VRS without equipping them with adequate skills and training to re-enter the job market, has resulted in a huge loss of productive workforce. Many workers who exited the manufacturing sector through the VRS route have joined the unorganized sector as new poor. A study finds that 35 per cent of the displaced workers who are working as casual labourers are not employed even for a full week.

Recommendation of the Second National Commission on Labour

The Government of India composed the Second National Commission on Labour (SNCL) on 15 October 1999 under the chairmanship of Ravindra Verma. The commission submitted its report to the government on 29 June 2002. It made wide-ranging recommendation on various facets of labour, viz. social security, women and child labour, skill development, review of law wages, labour administration, and so on. SNCL has emphasized on the need for providing flexibility to employers in handling labour to promote competitiveness and efficiency in the current context of globalization of the economy and the rapid technological progress that was achieved. However, it tried to provide some safety net cushions to the workers to lessen the pain of adjustment. They are mentioned below:

- The commission has attempted to provide few measures to security and some institutional mechanism to instil confidence in workers and make employers responsible. The firm should clear all dues to workers before effecting retrenchment or closure.
- The commission has tried to take into account both economic and social consideration workers need a higher compensation and at the same time the economic conditions of the firm also matter, hence it has recommended differential rates of compensation-lower rate of compensation in case of sick firms and higher one for healthy firms.
- The commission adumbrates the logic that if the employer could decide the size of employment at the start of the business, there is no reason as to why he should not do so during the conduct of the business. It accordingly revokes the statutory obligation to issues notice of change.
- The commission has recommended full freedom to the employers to layoff or retrench workers in all establishment, thus removing the need for getting permission from the government to effect these which is currently in vogue. If the layoff continues for a month then the employer needs to obtain a post facto permission for the government.
- It has restored the original threshold limit for the need to get prior approval from the government for closure; it requires firm employing 300 or more workers to get prior permission from the government for closure. Under the industrial dispute of 1947, the threshold limit is 100 workers. Then finance minister Yashwant Sinha (2001) had proposed to raise this limit to 1000 workers. Under the recommendations of SNCL, it is recommended that if employers employing less than 300 workers would not require prior approval from the government for closure.
- The commission has clearly given the employers almost a free hand in handling labour as compared with present restrictive set up. However, employers

have to consult the trade unions and cough up more money as compensation to the affected workers and provide longer notice period.

- The commission has recommended use of contract labour for conduct of non-core activities and for sporadic and seasonal demand. It has allowed employment of contract labour even for core activities. The commission created new distinction, namely core and non-core in place of existing perennial and non-perennial activities. These recommendations will increased labour flexibility and lead to such a restructuring of labour market that workers would be losers as contractual labour will replace regular in many activities. To reduce the adverse impact of these recommendations the commission advocates that contract labour be remunerated at the same rate as regular workers in the same organization doing similar work.

Trade unions have vehemently opposed the recommendations of SNCL. They do not believe in the employment generation potential of flexibility. SNCL emphasized on recommendation of contractual labour that due to this the Trade Union fear that only low quality jobs will be created. The employers will misuse the freedom of the fight to hire and fire. They expected that both jobs and income security to be under threat. The recommendation would create unemployment adding to already alarming level of unemployment.

In India, the Industrial Disputes Act, 1947 imposes restrictions on employers in the matter of reducing excess staff by retrenchment, by closure of establishments and the retrenchment process involved lot of legalities and complex procedures. In addition, any plans of retrenchment and reduction of staff and workforce are subjected to strong opposition by trade unions.

Recent Amendments in Labour Laws: Promoting Equity and Welfare

The recent amendments in labour laws are mentioned below:

- The Payment of Wages Act, 1936 amended to enhance the wage ceiling for its applicability. It is presently fixed at ₹ 24000 per month.
- The Payment of Bonus Act, 1965 amended to enhance the eligibility limit from ₹ 10, 000 per month to ₹ 21,000 and calculation ceiling from ₹ 3500 to ₹ 7000 or as fixed by the Government while making employees employed through contractors on building operations eligible for payment of bonus under the Act.
- The Apprentices Act, 1961 amended, *inter alia*, to provide for reservation for other Backward Classes.
- The Maternity Benefit Act, 1961 amended to enhance the medical bonus to Rs 3500 and also empowering the Central Government to increase it from time to time before every three years, by way of notification in the Official Gazette, subject to a maximum of ₹ 20,000/-.

NOTES

- The Employees State Insurance Act, 1948 amended to improve the quality of delivery of benefits under the scheme and also to enable ESI infrastructure to be used to provide health care to workers of the unorganized sector.
- The Payment of Gratuity Act, 1972 amended for raising the ceiling of Gratuity for employees in the private sector to ₹ 20 Lakh from ₹ 10 lakh.
- The Plantations Labour Act, 1951 amended to provide safety and occupational health care to plantations workers.

Approaches to Employment Generation

The Indian Government has taken up major measures in order to deal with the problem of unemployment. Some of the measures are explained in the subsequent paragraphs.

Employment and Unemployment Situation in India

Currently, India is passing through an unprecedented phase of demographic changes. The ongoing demographic changes are likely to contribute to an ever-increasing size of labour force in the country. The Census projection report shows that the proportion of population in the working age group (15–59 years) is likely to increase from approximately 60 in 2011 to more than 64 per cent by 2021.

During the post-reform period, changes in the employment scene have occurred in the form of growth rates, sectoral changes in employment and inter-state disparity in employment. Between 1980 and 1990 growth rate in total employment declined. The fall in employment was seen in both rural and urban areas. Decline in urban employment has been relatively sharper as compared to rural employment. This could be due to an increase in non-farm jobs in rural areas. However, during the same period, the overall economic growth was higher. This implied that the higher growth was achieved without corresponding increase in employment a jobless growth. Conversely, the unemployment rate has been growing faster during the post-reforms period. Interestingly, during post-reforms period male unemployment has grown faster than female unemployment. Open unemployment is more acute in urban areas as compared to rural areas. Along with unemployment, the problems of under-employment (both visible and invisible) also add to the problem.

Considering, the incremental labour force being added to the existing backlog of unemployed population, it is necessary to generate at least 10 million new jobs every year. Moreover, the ongoing demographic change in India where economically active population (between the age group of 15–59) is rising at a higher rate adds urgency to the task of job creation. In the beginning of planning era in the country, the government did not pay attention to the solution of unemployment problem, but it was given serious attention since fourth five-year plan.

Active labour market policies (ALMPs) are recognized as an important strategy for providing immediate access to employment for less advantaged groups in the labour market. In India, ALMPs are pursued to generate both wage as well as self-employment. The major employment generation programmes, which are currently in operation in India, include, Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), Prime Minister's Employment Generation Programme (PMEGP), Swarnajayanti Gram SwarozgarYojana (SGSY) and Swarna Jayanti ShahariRozgarYojana (SJSRY). These programmes have reflected immense potential for generating short-term rural wage employment as well as sustainable self-employment. The schemes are explained in the subsequent paragraphs:

(i) Swarnajayanti Gram Swarozgar Yojana (SGSY) now known as DDU-AY

SGSY was launched with effect from 1 April 1999 which has replaced Integrated Rural Development Programme (IRDP), Development of Women and Children in Rural Areas (DWCRA), Training Rural Youth for Self-Employment (TRYSEM), and Million Wells Scheme (MWS). It aims at promoting micro enterprises and helping the rural poor into Self-Help Groups (SHG). This scheme covers all aspects of self-employment like organisation of rural poor into SHG and their capacity building training planning of activity clusters, infrastructure development, financial assistance etc. The scheme is being implemented on a cost-sharing basis between the Centre and States in the ratio of 75:25 for States other than North-Eastern States where it is 90:10. Since inception (1.4.1999) up to March 2010, 37.87 lakh Self-Help Groups have been formed out of which 25.89 lakh are women groups 68 per cent). The total swarozgaris assisted during the period were 140.61 lakh out of which 66.43 lakh Swarozgaris were SC/STs and 82.28 lakh Swarozgaris were women, which are 46 per cent and 58 per cent respectively.

Special projects have to be innovative and replicable in nature. Since inception of the scheme, 335 projects have been sanctioned till March 2010. Under the Special projects, the focus is on placement linked skill development and marketing linkages.

Under this scheme, Rural Self-Employment Training Institute (RSETI) has been set up in each district to help rural BPL youth. During 2009–11 77,000 rural youth were trained in 99 RSETI during 2009–10. It was merged with National Rural Livelihood Mission in 2011 and later into Deen Dayal Upadhyay Antyodaya Yojana. During the FY 19-20, the mission mobilized 6.47 lakhs rural households and created 58.67 lakhs SHGs.

(ii) Employment Assurance Scheme (EAS)

Employment Assurance Scheme was started on 2 October 1993 for implementation in 1,778 identified backward Panchayat Samitis of 257 districts situated in drought prone areas, desert areas and hilly areas. It was restructured in 1999-2000 to make it a single wage employment programme and implemented as a Centrally Sponsored Scheme on a cost-sharing ratio of 75:25 between Centre and States. It aims at providing 100 days of unskilled manual work to rural poor.

(iii) Sampoorna Gramin Rozgar Yojana (SGRY)

SGRY was launched in September 2001. The scheme aims at providing wage employment in rural areas and also food security, along with the creation of durable community, social and economic assets. The ongoing Employment Assurance Scheme (EAS) and Jawahar Gram SamridhiYojana (JGSY) have been fully integrated within the scheme with effect from April 2002. And this scheme itself is now a part of the Mahatma Gandhi National Rural Employment Guarantee Assistance Scheme.

(iv) Swarna Jayanti Shahari Rozgar Yojana (SJSRY) now known as NULM

SJSRY effected from 1 April 2009. It provides gainful employment to the urban unemployed and under employed poor, by encouraging the setting up of self-employment ventures by the urban poor and also by providing wage employment and utilizing their labour for construction of socially and economically useful public assets. The revamped SJSRY has five components. These are: (a) the Urban Self-Employment Programme (USEP) which targets individual urban poor for setting up of micro enterprises; (b) the Urban Women Self-help Programme (UWSP) which targets urban poor women self-help groups for setting up of group enterprises and providing them assistance through a revolving fund for thrift and credit activities; (c) Skill Training for Employment Promotion amongst Urban Poor (STEP-UP) which targets the urban poor for imparting quality training so as to enhance their employability for self-employment or better salaried employment; (d) the Urban Wage Employment Programme (UWEP) which seeks to assist the urban poor by utilizing their labour for the construction of socially and economically useful public assets, in towns having population less than 5 lakh as per the 1991 census; and (e) the Urban Community Development Network (UCDN) which seeks to assist the urban poor in organizing themselves into self-managed community.

National Urban Livelihoods Mission (NULM) was launched by the Ministry of Housing and Urban Poverty Alleviation (MHUPA), Government of India in 23rd September, 2013 by replacing the existing Swarna Jayanti Shahari Rozgar Yojana (SJSRY).The NULM will focus on organizing urban poor in their strong grassroots level institutions, creating opportunities for skill development leading to market-based employment and helping them to set up self-employment venture

by ensuring easy access to credit. The Mission is aimed at providing shelter equipped with essential services to the urban homeless in a phased manner. In addition, the Mission would also address livelihood concerns of the urban street vendors.

(v) Prime Minister's Employment Generation Programme (PMEGP)

Prime Minister's Employment Generation Programme (PMEGP) is a newly-launched (in August, 2008) credit linked subsidy programme for generation of employment opportunities through establishment of micro enterprises in rural as well as urban areas. The objectives of the programme are: (i) to generate employment opportunities in rural as well as urban areas of the country through setting up of new self-employment ventures/projects/micro enterprises; (ii) to bring together widely dispersed traditional artisans/rural and urban unemployed youth and give them self-employment opportunities to the extent possible, at their place; and (iii) to provide continuous and sustainable employment to a large segment of traditional and prospective artisans and rural and urban unemployed youth in the country, so as to help minimize distress migration of rural youth to urban areas.

(vi) Pradhan Mantri Gramodaya Yojana (PMGY)

PMGY was introduced in 2000–01 with the objective of focussing on village level development in five critical areas—health, primary education, drinking water, housing and rural roads. PMGY includes three major projects:

- **Pradhan Mantri Gram Sadak Yojana:** PMGSY was launch on 25 December with the objective of providing road connectivity through good all-weather roads to all rural habitations.
- **Pradhan Mantri Gramodaya Yojana (GraminAwas):** This scheme is to be implemented on the pattern of Indira AwasYojana with the objective of sustainable habitat development at the village level to meet the growing housing needs of the rural poor.
- **Pradhan Mantri Gramodaya Yojana (Rural Drinking Water Project):** Rural Drinking Water Project was launched with the objective of developing projects for providing water harvesting water conservation and drinking water to drought prone areas.

The Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)

The MGNREGA aims at enhancing livelihood security of households in rural areas of the country by providing at least one hundred days of guaranteed wage employment. The ongoing programmes of SGRY and National Food for Work Programme (NFFWP) were subsumed within the NREGS. The MGNREGA Act was notified in 200 districts in the first phase with effect from 2 February 2006 and then extended to an additional 130 districts in the financial year 2007–08. The Act notified throughout the country with effect from 1 April 2008. Under this

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scheme 5.26 crore household were provided employment during 2009–10. Under this scheme, maximum employment during 2009–10 was provided in Rajasthan by Andhra Pradesh, Uttar Pradesh Madhya Pradesh Tamil Nadu and Bihar. About 4.10 crore households have been provided employment during 2010–11 till December 2010. Many initiatives are being taken for better and more effective implementation of the MGNREGA. In the FY 19-20, ₹ 4.51 crore households were provided with employment and in the process 177.47 crore person-days of employment was generated.'

Check Your Progress

6. What are the causes of disguised unemployment in India?
7. What is seasonal unemployment?
8. What are the causes of educated unemployment?
9. What are the ways in which the Indian government can promote women employment?
10. What were the objectives of Trade Union Amendment Bill 2000?
11. What do you mean by exit policy?
12. What is the Voluntary Retirement Scheme?
13. Name the three components of National Renewal Fund.

7.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The schemes of the Ministry of Social Justice and Empowerment are meant for the weaker sections of society, including women.
2. Two social welfare schemes for persons with disabilities include:
   - Assistance to Disabled Persons for purchase/Fitting of Aids and Appliances (ADIP) Scheme
   - Scholarship for Students with Disabilities
3. The objective of Public Distribution System (PDS).is to provide cheap and subsidized food grains to the poor.
4. PMGY was introduced in 2000–01 with the objective of focussing on village level development in five critical areas such as health, primary education, drinking water, housing and rural roads.
5. The Annapurna Scheme became effective from April 2000 as an entirely Centrally Sponsored Scheme. The main purpose of this scheme was to provide food security to meet the needs of senior citizens.

6. Disguised unemployment arises in India due to the following reasons:
   - Increasing pressure of population on land
   - Lack of alternative employment opportunities
   - Involvement of more and more people in agriculture since it is a family occupation
7. When unemployment arises due to changes in season, it is termed as seasonal unemployment. It is found in agricultural sector and seasonal industries. Agriculture in India is a seasonal occupation. Labourers find work for five to seven months a year, i.e., during the sowing and harvesting season. They remain unemployed for the remaining period
8. Educated unemployment occurs due to the following reasons:
   - Expansion of education facilities
   - Educational system is not job oriented
   - Educated persons consider many jobs to be beneath themselves
9. The Government of India can take the following steps to promote women employment:
   - Residential accommodation for working women on a large scale
   - Education and training facilities for working mothers
   - Availability of crèches for the children of working mother
10. Parliament has passed Trade Union Amendment Bill, 2000. The bill was introduced with objectives: (i) to control multiplicity of Trade Unions (ii) establishing industrial democracy (iii) encourage well-managed expansion of trade unions.
11. It refers to the right or ability of an industrial unit to withdraw from or leave an industry or in other words to close down. The need for such a policy arises as a result of modernization, technology upgradation, restructuring as well as closure of industrial units. Such a policy will allow employers to shift workers from one unit to another and also retrench excess labour.
12. The government initiated a Voluntary Retirement Scheme (VRS) in 1988 to help them to lay off excess numbers and to improve the age mix and skill mix. It was introduced as an alternative legal solution to solve this problem. It is the most humane technique to provide overall reduction in the existing strength of the employees. It is a generous, tax-free severance payment to persuade the employees to retire from the company voluntarily
13. The Employment Generation Fund(EGF), the National Renewal Grant Fund(NRGF), and the Insurance Fund for Employees (IFE) are the three components of the National Renewal Fund.

7.6 SUMMARY

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- Programme evaluation is done to gauge and improve the conceptualization, design, planning, administration, implementation, effectiveness, efficiency and utility of social interventions and human service programmes.
- To ensure social justice to the disabled on equitable terms, the Central Government enacted a comprehensive legislation viz. The Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995. The policy envisages a complete package of welfare services to the physically and mentally disabled individuals and groups. It also seeks to deal effectively with the multidimensional problems of the disabled population.
- Six national institutes have been set up in India to cater to the needs of the disabled population. These institutes also provide long term training programmes and short term degree and diplomas courses in Physiotherapy, Occupational Therapy, Mental retardation, Education of the deaf, Communication Disorders, and other courses.
- Volunteer social work is a type of social service. Helping the helpless is a type of social service. It is a service rendered to any person on the basis of a desire to serve which is inspired by the feeling of helping others. Thus, the term 'social service' is used to denote help given by a volunteer to an individual or group at the time of need or to enhance the welfare of individuals or the community through personal efforts or by collective action.
- Poverty alleviation and improvement in the standard of living of the masses has been one of the most important objectives of planning in India. However, the emphasis that is laid on the objective of poverty alleviation and strategy to achieve this objective has changed over the years.
- Since the Fifth Five Year Plan (1974–79), poverty alleviation has been adopted as an explicit objective of our economic planning. Since then, a number of poverty alleviation programmes have been launched with the specific objective of reducing poverty. In the 1980s and 1990s, the government undertook various programmes which were more comprehensive and made a direct attack on rural and urban poverty.
- The National Social Assistance Programme (NSAP), Indira Awaas Yojana (IAY), Shiksha Sahayog Yojana (SSY), Pradhan Mantri Gramodaya Yojana (PMGY), Samagra Awaas Yojana (SAY), Natural Food for Work

Programme (NFWP), Krishi Shramik Samajik Suraksha Yojana (KSSSY), Jawaharlal Nehru National Urban Renewal Mission (JNNURM), Valmiki Ambedkar Awaas Yojana (VAAY), Antodaya Anna Yojana (AAY) are some of the important poverty alleviation programmes in operation.

- Poverty is an intricate phenomenon of different dimensions rather than just the economic dimension. Hence, any programme for poverty alleviation should address the issue of poverty from broader social and economic perspectives.
- One of the most acute challenges that the Indian economy has been facing is the mounting rate of unemployment. Unemployment is defined as a situation wherein able bodied persons fail to find a job even though they are willing to work at the prevailing wage rate.
- The problem of unemployment and underemployment represents a challenge to the developing countries just as the problem of cyclical unemployment is a challenge to the countries where advanced industrial development has taken place.
- Voluntary unemployment, disguised unemployment, open unemployment, seasonal unemployment, technological unemployment, educated unemployment, agricultural unemployment and industrial unemployment are some of the types of unemployment.
- Demographic changes resulting in a growing proportion of economically active younger population, throws a major challenge as well as an opportunity for the economy. The trade off between capital intensive (higher productivity) and labour intensive (employment generating) techniques adds to the complexities.
- Factories Act of 1948, Minimum Wages Act 1948, Shops and Establishments Act, Industrial Disputes Act of 1947, Industrial Employment (Standing Orders) Act, Contract Labour (Regulation and Abolition) Act, 1970, Workers' Welfare Funds, Trade Union Act of 1926, and Trade Union (Amendment) Act, 2001 are some of the legislative framework established by the Indian government to protect the rights of workers.
- The Indian government has been working effectively in order to bring about major reforms in the labour market and make it more worker-friendly.
- Exit policy refers to the right or ability of an industrial unit to withdraw from or leave an industry or in other words to close down. The proposal to introduce an exit policy was first mooted in 1991 when it was felt that

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without labour market flexibility, efficient industrialization would be difficult to achieve. The need for such a policy arises as a result of modernization, technology upgradation, restructuring as well as closure of industrial units. Such a policy will allow employers to shift workers from one unit to another and also retrench excess labour.

- Most of the public sector undertakings are overstaffed; the government initiated a Voluntary Retirement Scheme (VRS) in 1988 to help them to lay off excess numbers and to improve the age mix and skill mix.
- In order to protect the interest of workers, the Government of India created a National Renewal Fund (NRF) in February 1992. The Employment Generation Fund(EGF), the National Renewal Grant Fund(NRGF), and the Insurance Fund for Employees (IFE) are the three components of the National Renewal Fund.
- The Scheme of Counselling, Retraining and Redeployment (CRR) of Rationalized Employees of Central Public Sector Undertakings (CPSUs) aims at providing counselling, retraining and redeploying the employees who have lost their jobs.
- The Government of India composed the Second National Commission on Labour (SNCL) on 15 October 1999 under the chairmanship of Ravindra Verma. It made wide-ranging recommendation on various facets of labour, viz. social security, women and child labour, skill development, review of law wages, labour administration, and so on.
- The Indian Government has taken up major measures in order to deal with the problem of unemployment. Some of the measures are Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), Prime Minister's Employment Generation Programme (PMEGP), DDU-AY and NULM.

7.7 KEY WORDS

- **Social Service:** The term is used to denote help given by a volunteer to an individual or group at the time of need or to enhance the welfare of individuals or the community through personal efforts or by collective action.
- **Unemployment:** Unemployment is defined as a situation wherein able bodied persons fail to find a job even though they are willing to work at the prevailing wage rate.

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- **Voluntary unemployment:** Those people are known to be voluntarily unemployed who are not working by choice. They do not avail of an employment opportunity because they consider such a job as below their dignity.
- **Disguised unemployment:** Disguised unemployment means that the number of workers employed in a job is much more than are actually required.
- **Trade Union:** Trade Union is an association of workers who form a unit in a particular trade, industry or company. The objective of a trade union is to ensure that the pay, benefits, working conditions, etc. of the workers is up to the mark.

7.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the types of unemployment?
2. What are the effects of unemployment?
3. What are the objectives of National Renewal Fund (NRF)?
4. What were the recommendations of the Second National Commission on Labour (SNCL)?

Long-Answer Questions

1. Analyse some of the important poverty alleviation programmes in rural and urban areas.
2. Describe some of the major problems posed by unemployment in developing countries.
3. Discuss the measures which can be taken to tackle unemployment in India.
4. Critically evaluate the prominent labour legislations implemented to ensure the rights of workers.

7.9 FURTHER READINGS

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BLOCK-III

PRICE, MONETARY AND FISCAL POLICY IN INDIA

UNIT 8 HISTORY OF INFLATION AND PRICE POLICY

Structure

8.0 INTRODUCTION

Inflation is the rise in the general level of prices. This is equivalent to a fall in the value or purchasing power of money. In simple words, inflation is an increase or rise in prices relative to money available. In other words, when inflation occurs, you get less for your money than you used to get. Inflation may be caused by an increase in the quantity of money in circulation. It also occurs when there are many people and organizations with enough market power to increase their prices. The money supply is also thought to play a role in determining the levels of inflation, although there are differences of opinion on how important it is.

There are various types of inflation, such as open and suppressed inflation, demand-pull or excess demand inflation, cost-push inflation, internationally-generated inflation, ratchet inflation, mark-up inflation and international liquidity inflation. Of them, demand-pull or excess demand inflation, and cost-push inflation are most common. Demand pull inflation arises where there is an increase in aggregate demand in an economy relative to aggregate supply. This is commonly described as 'too much money chasing too few goods'.

Various methods have been suggested to stop inflation, such as simply instituting wage and price controls (which were tried in the United States in the early 1970s). However, most economists regard price controls as counterproductive as they tend to alter the functioning of the economy.

In this unit, you will be able to understand the concept, types and characteristics of inflation. This unit will also deal with the types of monetary policies which assist in controlling inflation.

8.1 OBJECTIVES

After going through this unit, you will be able to:

- State the types of inflation
- List the causes of inflation
- Discuss the history of inflation in India
- Explain the price policy of India

8.2 UNDERSTANDING INFLATION/PRICE RISE

A persistent rise in the general level of prices is known as inflation. Since, inflation is a sustained rise in the general price level, one must first determine what the general price level was at a given time and then decide how much it has changed. Because there are a number of different measures of doing this, there are a number of different measures of the general price level. The most often used are consumer price index, whole sale price index, and the GDP deflator.

In microeconomics, supply and demand of a commodity determines equilibrium prices and quantities in specific markets. In macroeconomics, there is similar interest in prices and quantities. Macroeconomists are not interested in individual prices, but in the price level. The general price level is an average price of all goods and services in the economy. Price level in macroeconomics is determined on the basis of money supply on one hand and output (GNP) on the other hand. In equation form it is written as under:

$$\text{Price Level} = \frac{\text{Money supply}}{\text{GNP}}$$

8.2.1 Characteristics of Inflation

People often worry about inflation out of a fear that rising prices will lower their standard of living. Alarming increases in housing prices or food prices are taken as proof that standards of economic well-being are falling. This fear is a classic example of the ceteris paribus fallacy. During inflations, prices of outputs and inputs, wages, rents, and interest rates tend to rise together. While, the prices of the things we buy tend to rise, so do the prices of the things we sell (such as labour). Living

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standards are determined by the relationship between the income people have to spend and the prices they have to pay. If income is rising-faster than prices, living standards are rising, if income is rising slower than prices, living standards are falling. The relationship between changes in income and changes in prices determines the direction of change in economic well-being.

To illustrate the logical fallacy of necessarily equating rising prices with falling living standards or of equating falling prices with rising living standards, compare the Great Depression of the 1930s with the inflationary 1970s. Between 1929 and 1933, there was a 25 per cent drop in prices, while people's incomes fell by 45 per cent. Falling prices did not result in rising living standards. Because incomes fell more than prices between 1929 and 1933, living standards dropped even though prices were falling. Between 1970 and 1983, prices increased by about 250 per cent. However people's incomes went up by about 300 per cent. Even though, the economy was experiencing high inflation, living standards were pushed up by incomes rising more rapidly than prices.

Although, inflation does not automatically lower standards of living, inflation can redistribute income among members of society; it call reduce economic efficiency; and it can cause changes in output and employment.

Fixed Money Receipts and Fixed Money Payments

Inflation is like a tax on fixed money receipts and like a subsidy on fixed money payments. The income redistribution effects inflation depend upon how well people anticipate inflation. People who are to receive money payments in the future can avoid the inflation tax by correctly anticipating inflation. The lender who anticipates inflation correctly will demand an interest rate that compensates for the inflation tax. Union negotiators will refuse to accept wage increases that do not compensate for inflation.

Inflation distributional effects depend upon how well people anticipate inflation. It is clearly in the interests of persons who enter into contracts involving money payments over time to try to anticipate inflation.

If inflation is correctly anticipated, it will not redistribute wealth from those scheduled to receive money to those scheduled to pay money.

It is easier to anticipate inflation when inflation is steady. Inflation rates of the past are good predictors of tomorrow's inflation rates. If inflation is erratic and intermittent, it is difficult for people to anticipate inflation. If the inflation rate is 6 per cent in year, 18 per cent the next year, and 3 per cent in the following year, it will be difficult to anticipate what the actual rate of inflation will be.

Inflation and Economic Inefficiency

When inflation is intermittent, predicting the rate of inflation becomes a difficult business. Nobel laureate Milton Friedman points out:

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> 'Under such circumstances, the most valuable quality on the part of a businessman becomes his ability to forecast the changes in prices and to adjust rapidly to them.
>
> This becomes more important than his ability as organizer or as a manager or as a person who can see where there are profitable opportunities. The result is that some of the most valuable and scarcest resources in the economy are diverted into activities that are socially unproductive.'

Inflation leads to the making of speculative investments in place of investments in plants, equipment, and inventories that would raise the productive potential of the economy. By trying to outwit everyone else, those who expect more inflation will speculate in real estate, foreign currencies, gold, and art objects. Inflation causes people rush to art auctions and to invest in question able real estate schemes to avoid the inflation tax.

The negative effects of inflation on economic efficiency are most pronounced during hyperinflations, when prices may double daily or twice daily. Workers become reluctant to keep their wages in money (preferring to be in terms of products), and the money that is received is spent immediately. Businesses refuse to enter into fixed contracts and most transactions involve barter exchanges of goods and services. In other words, hyperinflations result in the loss of the efficiency of money transaction. Most efforts in such an economy are directed at avoiding the 'inflation tax' rather than at productive economic activities.

Inflation and Real Output and Employment

As just described, anticipated inflation can divert resources from productive to basically unproductive uses. However, inflation can affect economic output and employment in a more direct manner by motivating people to produce more, to work more, or to buy more than they would have otherwise.

Inflation and Interest Rates

High interest rates accompany high rates of inflation. The triple-digit or more inflation rates of Bolivia, Argentina or Israel were accompanied by triple-digit or more interest rates. When U.S. inflation was running at its highest level in modern times in 1979-80, banks were charging more than 20 per cent interest. During the low inflation rates of the 1950s and early 1960s, banks charged 3.5 per cent interest on bank loans high inflation leads to a high nominal interest rate.

The nominal interest rate is the price of credit unadjusted for inflation. It is expressed as the ratio of the annual dollar interest cost to the dollar amount loaned. A 5 per cent nominal interest rate means that the annual interest charge on a 1000 loan is 50. A 10 per cent nominal interest rate means that the annual interest charge on a 1000 loan would be 100.

The real interest rate is the price of credit adjusted for inflation. It is approximately equal to the nominal interest rate minus the annual rate of inflation.

The Wage Price Spiral

The wage/price spiral is the phenomenon of higher prices pushing wages higher and then higher wages pushing prices higher, or vice versa. This spiral is sustained with the monetary authorities ratify the resulting supply side inflation.

As long as monetary authorities continue to ratify the increase in wages, the wage/price spiral can continue indefinitely. A necessary component of the wage/price spiral is the accompanying rise in the money supply.

An economy that aims to maintain full employment can be subject to wage/price spirals. If the economy suffers an adverse supply shock, monetary authorities must increase the money supply to prevent unemployment from rising, and prices will be bid up even more. Any action that threatens to raise unemployment will be counteracted by aggregate-demand increases. Government policy is more likely to prevent price declines than price increases, building an inflationary bias into the economy.

The wage/price spiral cannot be halted painlessly. If the government ceases to ratify supply-side inflation (by refusing to let the money supply grow), the wage/price spiral will be broken; but the economy will have to live with unemployment until the self-correcting mechanism works.

Wage and Price Controls: One approach to controlling the inflationary wage/price spiral is to use wage and price controls, or government-imposed rules and laws to govern prices and wages. In their mild form, such controls could be an incomes policy of voluntary rules and guidelines concerning wage and price increases. For example, the government may decree that prices can be raised only at the same rate as costs; it may say that wages and prices cannot increase by more than x per cent in a given year; it may set rules on profit margins. These rules can be mandatory or voluntary. The use of wage and price controls often requires a substantial bureaucracy to monitor compliance.

Government Deficit and Inflation

The federal deficit can contribute to inflation indirectly through its effect on the money supply. If the newly issued government bonds are sold only to the public, the money supply is not affected, but interest rates may be driven up as government and private borrowers compete for available investment funds. If there is an unwillingness to raise interest rates in the short run, the government can purchase the federal debt. When the government purchases government bonds, it injects new reserves into the banking system and the money supply expands. In effect, the government deficit is financed by 'printing money'.

The governmental deficit can contribute to inflation indirectly if increases in the national debt cause people to spend more. If people treat the government IOUs that they own as net wealth, a larger national debt means that people will spend more. In other words, if people look only at their increased holdings of

federal government IOUs and ignore the future taxes that must be collected to finance the debt, an increase in the national debt may motivate them to spend more and, thus, to drive up prices.

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8.2.2 Measurement of Inflation

If all prices rise at the same rate, there will be no problem in measuring the general level of prices. However, prices do not change at the same rate; some prices rise more rapidly than others. In other words, relative prices are changing while prices in general are rising.

Price Index

A price index is used to measure inflation when relative prices are changing.

A price index shows the current year's cost of a particular market basket as a per centage of the cost of the same market basket in some base year.

A market basket is the combination of goods and services consumed by a family. Price indexes measure the changing cost of purchasing the same market basket of goods in different years.

$$\text{Price index} = \frac{\text{Cost of standard market basket in current year}}{\text{Cost standard market basket in base year}}$$

For example, suppose 2011 is the base year and 2012 and 2013 are the two current years in the formula above. Assume the market basket of goods costs 200 in 2011 (the base year), 220 in 2012 (the first current year), and 230 in 2013 (the second current year). The value of the price index is 100.0 in the base year 2011 (200/200 × 100 = 100.0). The price index in 2012 is 110 (which is calculated as 2220/200 × 100), and the price index in 2013 is 115 (230/200 × 100).

The annual per centage change in prices from one year to the next is calculated from the price indexes by the formula:

Annual per centage price change

$$= \frac{\text{Year 2 price index} - \text{Year 1 price index}}{\text{Year 1 price index}}$$

Applying the 2011, 2012 and 2013 price indexes to the formula for calculating annual per centage price changes, prices increased 10 per cent in 2012 [(110 – 100)/100] and 4.6 per cent in 2013] (115 - 110)/110].

There are a number of different measures of the general price level. The most often used are discussed as follows:

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1. The Consumer Price Index (CPI)

The best known price index is the consumer price index. The CPI is the most commonly used measure of inflation. The inflation expressed in terms of CPI is called core inflation. The total of 435 commodities are included for the calculation of CPI. Commodities are grouped into three categories, namely:

(i) Primary articles
(ii) Fuel, power, light and lubricants
(iii) Manufactured products

The consumer price index is computed in three versions. They are as follows:

(i) Consumer price index for rural labourers and agricultural labourers
(ii) Consumer price index for urban non-manual employees
(iii) Consumer price index for industrial workers

The concept of inflation adopted in India is expressed in terms of the movement in wholesale price index which is also popularly referred to as head-line inflation in India.

2. The GNP Deflator

The CPI measures changes in the prices of only those goods and services that families purchase for their own consumption. It does not measure the other goods and services that the economy produces for other uses. About 65 per cent of the gross national product (GNP), was devoted to personal consumption. The remaining 35 per cent was expended on business investment, government services, and exports and imports. The CPI, therefore does not measure changes in all prices. The general measure the rate of inflation is the GNP deflator.

The GNP deflator measures the change in the prices of all final goods and services produced by the economy.

The formula for calculation of GNP deflator is:

$$\text{GNP Deflator} = = \frac{\text{Nominal}\,GNP}{\text{Real GNP}}$$

In this way, it is own index of the price level of aggregate output or the average price of the components in total output or GNP relative to a base year. It is the inflation index that economists generally favour because it includes the widest number of goods.

Measuring changes in prices over time is difficult, one of the most vexing price indexing problems is how to include quality changes. For example, say 2016 cars have a new style and, unlike, 2014 models provide airbags as a standard feature. These cost 5 per cent more. Has the price of cars really gone up 5 per cent or is the 5 per cent simply the cost of improving cars' design and equipment with significant changes in goods' quality occurring every year, most economists

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do not worry about small amounts of inflation, because it is not even certain that such small changes actually represent inflation.

One important way in which inflation indexes are used is to separate changes in real output from changes in nominal output. Real output is the total amount of goods and services produced, adjusted for price level changes. It is the measure of output that would exist if the price level had remained constant. For example, say total output rise from ₹ 4 lakhs to ₹ 5 lakhs. Thus, nominal output has risen by 25 per cent. However, the price level has risen 20 per cent. To determine how much less, we must adjust the nominal figures to account for inflation. This is called deflecting the nominal figures, therefore 5 lakhs is divided by 1.2 (20 per cent increase in price level) = 4.1 lakh is the output that would have existed if the price level had remained constant.

8.2.3 Types of Inflation

Inflation is of various types, depending on the intensity and causing factors.

1. Types of inflation according to intensity

The intensity of inflation is measured according to its value. If the inflation has increased say by 2 to 3 per cent, it will be designated as moderate. Even moderate inflation is divided into creeping and walking inflation. If the rate of inflation is between 5 to 10 per cent, it is known as running inflation, once inflation hits 5 per cent or 6 per cent, it is definitely no longer a little thing. Inflation of 10 per cent or more is significant. Once it hits digits –100 per cent or more, it's a hyperinflation. Brazil, Israel and Argentina have frequently had hyperinflations.

During hyperinflations, prices might double every month, inflation could double daily or even hourly. Different countries have experienced hyperinflations in the course of their histories. Recently, the annual inflation rate in Israel was 800 per cent, and the annual inflation rate in Bolivia was running at an annual rate of 25,000 per cent in the mid-1980s. The best known historic case of hyperinflation was the German hyperinflation of the 1920s, which helped bring Hitler to power. In November 1923, the German mark had fallen to the point where one American cent equalled 42 trillion marks! The American South experienced hyperinflation during the Civil War. People who have witnessed the destructive power of hyperinflation have a deep-rooted fear of inflation because they understand that hyperinflation can cause the destruction of the established social order.

2. Types of inflation according to causes

Opinion is divided on whether consumer prices in recent years have increased chiefly because industry has invested too much and government has spent too much or because big business has raised material prices or labour has raised wage rates two high. The issue is partly who is to blame for inflation.

With the help of the proposed concepts, the two basic model sequence of consumer price inflation can be easily described.

(i) Demand Pull Inflation

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Inflation has been described as 'too many dollars chasing too few goods'. Demand pull inflation is the 'too many rupees side of the inflation equation'.

Demand Pull inflation occurs when the amount of money purchasers want to spend increases more rapidly than the supply of goods and services, resulting in the bidding up of prices.

The increase in demand pulls up the general level of prices. Demand-side inflation is caused by events the motivate consumers, governments, or firms to desire to purchase more goods and services than they previously desired to purchase.

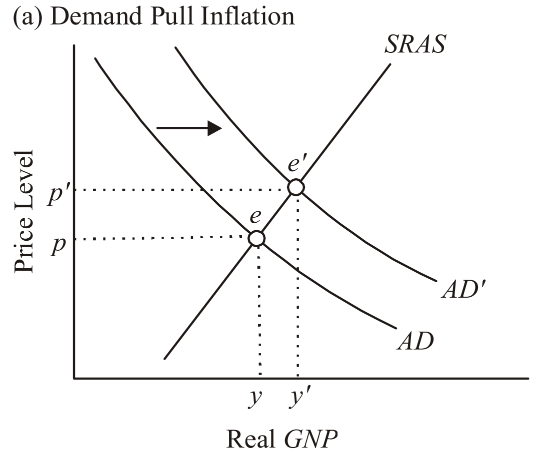


Figure. 8.1(a) Demand-pull Inflation

In Figure 8.1(a), the economy is initially operating at point *e*, where output is *y* and the price level is *P*. The short-run aggregate-supply curve, *SRAS*, is positively sloped—which means that the economy will produce more output only at a higher price level. If aggregate demand increases through an increase in the money supply, a lowering of taxes, an increase in government spending, or an autonomous upward shift in consumption, the aggregate-demand curve, *AD,* will shift to the right. At the new equilibrium, *e*′, more output (*y*′) is produced (and unemployment falls). The increase in demand has caused the equilibrium price level to rise (to *p*′). In Figure 8.1(a), the inflation caused by the increase in aggregate demand is demand-side inflation.

Demand-side Inflation: Money and Interest

Protracted and sustained inflation (such as we have experienced since the early 1930s) is primarily a monetary phenomenon. Protracted and sustained inflation is most likely caused by persistent increases in aggregate demand resulting from

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excess monetary growth. Supply-side effects tend to be one-shot affairs. In order for supply shocks to cause protracted inflation, there would have to be a sustained series of adverse supply shocks.

Any autonomous-expenditure increase can shift the aggregate-demand curve to the right. Monetary growth is only one potential cause of increases in aggregate demand. Only the money supply, however, appears to have grown in a sufficiently rapid and sustained manner to be pin-pointed as the cause of protracted inflation. The relatively rapid growth of the money supply makes it the most likely source of the autonomous-expenditure increases required to continuously raise aggregate demand. To explain the inflationary bias of the past 50 years, economists look first at the monetary theory of inflation.

(ii) Supply Side Inflation or Cost Push Inflation

Supply-side inflation or cost-push inflation occurs when increases in prices of inputs caused by reductions in their supply, generally cause fewer goods and services to be offered at prevailing prices, resulting in the bidding up of their prices.

The increase in costs pushes up the general price level. An example of supply-side inflation is the increase in energy prices that occurred in the 1970s as a result of the formation of OPEC and the Iran-Iraq war, which generally raised costs of production throughout the world economy.

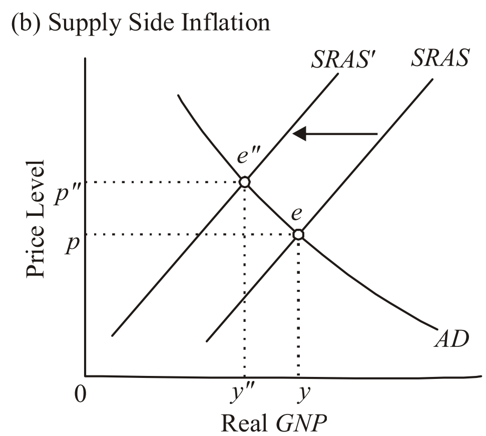


Figure. 8.1 (b) Supply-side Inflation

Supply-Side Inflation

In Figure 8.1(b), the economy is initially operating at point *e* again, producing output *y* at price level *p*. A reduction in aggregate supply—because of a decline in productivity, poor harvests, or autonomous increases in energy prices—shifts the aggregate-supply curve to the left from *SRAS* to *SRAS′*. The drop in aggregate supply disrupts the initial equilibrium of output and prices and shifts the equilibrium to *e″*. At price level *p*, aggregate demand exceeds aggregate supply, and prices rise (from *p* to *P″*). As prices rise, the economy moves back along the aggregate-demand curve, output falls to *y″*, and the unemployment rate rises. The reduction

in aggregate supply has raised both the price level and unemployment. In Figure 8.1(b), the inflation caused by the reduction in aggregate supply is supply-side inflation.

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Supply side: Supply Shocks

Supply-side inflation occurs when there is a recession in aggregate supply—when the SRAS curve shifts to the left, as in Figure 8.1 (b). The drop in aggregate supply moves the economy up the aggregate-demand curve to a lower level of output to a higher price level. Unlike demand-side inflation, which tends to raise output and employment in the short run, supply-side inflation brings the worst of both worlds: rising prices and lower output and employment.

Shifts in aggregate supply can be expected or unexpected. For example, the generally rising in technological advances would be expected to increase aggregate supply over time in a predictable manner. Of greater interest is an expected shift in aggregate supply, called a supply shock.

A supply shock unexpectedly shifts the short run aggregate supply curve.

An adverse supply shock reduces aggregate supply (the short-run aggregate-supply curve to the left). A favourable supply shock increases aggregate supply.

Causes of Supply Side Inflation

There is no single cause of supply-side inflation. Any factor that decreases aggregate supply can initiate supply-side inflation. Changes in labour productivity, autonomous increases in raw-material prices, crop failures, and changes in the way labour and product markers work can all reduce aggregate supply.

If the costs of production rise spontaneously, the economy will experience an adverse supply shock firms, on average, will supply fewer goods and services than before at prevailing prices, and aggregate supply will fall. As the aggregate-supply curve shifts to the left, the price level is pushed up.

The most dramatic case of supply-side inflation was the 1475 per cent rise in the price of imported oil between 1973 and 1980. When the Organization of Petroleum Exporting Countries (OPEC) discovered the magic of cartel pricing in 1973, the oil-importing countries of the world were hit with an enormous adverse supply shock. OPEC inflicted leftward shifts in the aggregate-supply curves of every oil-importing country. The oil-induced reductions of supply pushed up the general price level.

Ratification of Supply-Side Inflation

As Figure 8.2 demonstrated supply-side inflation reduces output and, hence, increases unemployment. Demand-side inflation, on the other may increase both output and employment.

In Figure 8.2, the economy is initially producing output of y_1, at a price level of p_1, (at point). The economy now suffers a supply shock—aggregate-supply

curve shifts to left (from *SRAS* to *SRAS′*). If aggregate demand is unchanged, the economy moves to e_2, producing less output, but at higher prices (prices rise from p_1 to p_2) output declines, the unemployment rate rise.

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If the government succumbs to pressure combat rising unemployment, it can raise money supply and increase aggregate demand (from *AD* to *AD′*).

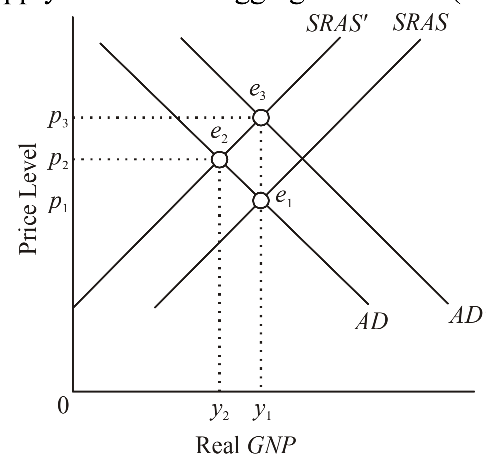


Figure. 8.2 The Ratification of Supply Shocks

As a consequence, the level rises even further—from p_2 to p_3, and the economy returns to its original level of output and employment. The process of responding to adverse supply shocks by increasing monetary growth is known as the ratification of supply-side inflation.

Ratification of supply side inflation results of the government increases the money supply to prevent supply side shocks from raising unemployment.

As a consequence of ratification, the supply-lock-induced unemployment has been eliminated, but the price level has been driven up even further.

8.2.4 Causes of Inflation

Main causes of inflation may be summarized under the following heads:

- **Demand-pull inflation**: This leads to aggregate demand growing faster than aggregate supply (growth is very rapid). Its characteristics are already discussed under the types of inflation.
- **Cost-push inflation:** This cause is also already discussed under the types of inflation. Higher oil prices feeding through into higher costs is an example of inflation due to a push in cost.
- **Devaluation:** This is done to increase the cost of imported goods, and also to boost the domestic demand.
- **Rising wages:** Higher wages increase firms' costs and increase consumers' disposable income to spend more. This leads to inflation.
- **Expectations of inflation**: Expecting inflation causes workers to demand wage increases and firms to push up prices. Once inflation sets in it is difficult

to reduce inflation. For example, higher prices will cause workers to demand higher wages causing a wage-price spiral. Therefore, expectations of inflation are important. If people expect high inflation, it tends to be self-serving.

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8.3 HISTORY OF INFLATION IN INDIA

In the early days of the Indian republic, other than 1956, inflation stayed at a controlled level below 10 per cent. No one could even set their own prices, since everything was government controlled. At some level integration issues would have given rise to price validity problems as well.

In the 1960s, India faced spiky inflation as wars hit the economy – the Chinese war in 1962, and then the war with Pakistan in 1965. Prices of wholesale goods spiked and after India devalued its currency, things got slightly better, with inflation going below the zero level in 1969.

The 1970s saw the great oil spike which led to extremes in inflation – the Emergency calmed things down. After 1977, when the emergency was lifted, prices spiked again, and spiked to over 18 per cent in 1981-82.

The rest of the 1980s were about benign inflation as rules were eased slowly over supply and prices. But government control flourished, with manufacturers being told how much of any commodity they could produce, how much they could increase capacity by, every year. Inflation spiked again in the 1990s as India devalued and went through payments crisis. The liberalization of the early 1990s helped keep inflation low as supply pressures eased and productivity increased. But even through the Russian crisis, the Asian currency crisis and the downturn after the 2000 dot-com bust, Indian inflation remained above zero and did not spike into double digits.

The 2008 oil price rise saw inflation temporarily go into double digits (not reflected in annual numbers) and interest rates went all the way to 9 per cent. The Lehman bust then took inflation down to very low numbers in 2009. As the elections removed the left from power in 2009, the subsequent recovery then took inflation back up vigorously, and it has been above the 8 per cent mark since then.

In 2010-11, inflation was at 9.6 per cent (official) which made it the highest since 1994-95, when it was 12.6 per cent.

In 2013, the consumer price index replaced the wholesale price index (WPI) as a main measure of inflation. In India, the most important category in the consumer price index is Food and beverages (45.86 per cent of total weight), of which cereals and products (9.67 per cent), milk and products (6.61 per cent), vegetables (6.04 per cent), prepared meals, snacks, sweets, etc., (5.55 per cent), meat and fish (3.61 per cent), and oils and fats (3.56 per cent). Miscellaneous accounts for 28.32 per cent, of which transport and communication (8.59 per cent), health (5.89 per cent), and education (4.46 per cent). Housing accounts for 10.07 per cent; fuel and light for 6.84 per cent; clothing and footwear for 6.53 per cent; and pan, tobacco and intoxicants for 2.38 per cent. Consumer price changes in India

can be very volatile due to dependence on energy imports, the uncertain impact of monsoon rains on its large farm sector, difficulties transporting food items to market because of its poor roads and infrastructure and high fiscal deficit.

Consumer price inflation in India increased to 7.59 per cent in January 2020 from 7.35 per cent in December, above expectations of 7.4 per cent. The inflation accelerated for the 6th straight month to the highest since May of 2014. Prices rose faster for fuel and light (3.7 per cent vs 0.7 per cent in December), miscellaneous (4.8 per cent vs 4.1 per cent), clothing and footwear (1.9 per cent vs 1.5 per cent) and pan, tobacco and intoxicants (3.6 per cent vs 3.4 per cent) but eased for housing (4.2 per cent vs 4.3 per cent). Cost of food and beverages increased at a slightly slower rate (11.8 per cent vs 12.2 per cent), namely vegetables (50.2 per cent vs 60.5 per cent) while faster increases were seen for cereals (5.3 per cent vs 4.4 per cent), milk (5.6 per cent vs 4.2 per cent), fruits (5.8 per cent vs 4.6 per cent) and pulses (16.7 per cent vs 15.4 per cent). The food alone rate slowed to 13.6 per cent from 14.1 per cent, which was the highest since November 2013. On a monthly basis, consumer prices fell 0.1 per cent after surging 1.2 per cent in December, the most since July of 2017.

Check Your Progress

1. Give the equation form of price level.
2. What is the wage/price spiral phenomenon?
3. What is the most commonly used measure of inflation?
4. When does demand pull inflation take place?

8.4 ANSWERS TO CHECK YOUR PROGRESS

1. The equation form of price level is given as follows:

   $$\text{Price Level} = \frac{\text{Money supply}}{\text{GNP}}$$

2. The wage/price spiral is the phenomenon of higher prices pushing wages higher and then higher wages pushing prices higher, or vice versa. This spiral is sustained with the monetary authorities ratify the resulting supply side inflation.

   As long as monetary authorities continue to ratify the increase in wages, the wage/price spiral can continue indefinitely. A necessary component of the wage/price spiral is the accompanying rise in the money supply.
3. The CPI is the most commonly used measure of inflation. The inflation expressed in terms of CPI is called core inflation.
4. Demand Pull inflation occurs when the amount of money purchasers want to spend increases more rapidly than the supply of goods and services, resulting in the bidding up of prices.

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8.5 SUMMMARY

- Inflation is the rise in the general level of prices. This is equivalent to a fall in the value or purchasing power of money. In simple words, inflation is an increase or rise in prices relative to money available.
- There are various types of inflation, such as open and suppressed inflation, demand-pull or excess demand inflation, cost-push inflation, internationally-generated inflation, ratchet inflation, mark-up inflation and international liquidity inflation.
- A persistent rise in the general level of prices is known as inflation. Since, inflation is a sustained rise in the general price level, one must first determine what the general price level was at a given time and then decide how much it has changed.
- People often worry about inflation out of a fear that rising prices will lower their standard of living. Alarming increases in housing prices or food prices are taken as proof that standards of economic well-being are falling.
- Inflation is like a tax on fixed money receipts and like a subsidy on fixed money payments. The income redistribution effects inflation depend upon how well people anticipate inflation. People who are to receive money payments in the future can avoid the inflation tax by correctly anticipating inflation.
- If inflation is correctly anticipated, it will not redistribute wealth from those scheduled to receive money to those scheduled to pay money.
- The wage/price spiral is the phenomenon of higher prices pushing wages higher and then higher wages pushing prices higher, or vice versa. This spiral is sustained with the monetary authorities ratify the resulting supply side inflation.
- The federal deficit can contribute to inflation indirectly through its effect on the money supply. If the newly issued government bonds are sold only to the public, the money supply is not affected, but interest rates may be driven up as government and private borrowers compete for available investment funds.
- If all prices rise at the same rate, there will be no problem in measuring the general level of prices. However, prices do not change at the same rate; some prices rise more rapidly than others. In other words, relative prices are changing while prices in general are rising.
- Inflation has been described as ‘too many dollars chasing too few goods’. Demand pull inflation is the ‘too many rupees side of the inflation equation’.
- Supply-side inflation or cost-push inflation occurs when increases in prices of inputs caused by reductions in their supply, generally cause fewer goods and services to be

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8.6 KEY WORDS

- **Inflation:** A persistent rise in the general level of prices is known as inflation.
- **Price index**: It is used to measure inflation when relative prices are changing.
- **Central Bank rediscount rate:** It is the rate at which central bank buys or rediscounts the eligible bills of exchange and other approved commercial papers presented by the commercial banks for building reserves.
- **Market basket:** It is the combination of goods and services consumed by a family.
- **Hyperinflation:** It occurs when prices shoot up at more than three-digit rate per annum.

8.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List the characteristics of inflation.
2. What are the types of inflation?
3. Write a short note on the causes of inflation.
4. Briefly mention the history of inflation in India.

Long-Answer Questions

1. Analyse the interrelation between inflation and interest rate.
2. Discuss the various ways of measuring inflation.
3. Differentiate between demand-side inflation and supply-side inflation.

8.8 FURTHER READINGS

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UNIT 9 POST-REFORM PERIOD OF INDIA

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Structure

9.0 INTRODUCTION

The Indian economy undertook some major changes in the year 1991. The New Economic Policy as you have studied in the earlier units was a big game changer as it brought the ethos of liberalization, privatization and globalization to the Indian Economy. The period before these economic reforms is called the pre-reform period and the period after it is referred to as the post-reform period. In the post-reform period, India is lagging behind in several sectors such as infrastructure, power, education, failure to raise labour-intensive manufacturing, slow social sector development and so forth. Reforms since 1991 have not been comprehensive enough to remove the bias towards capital and skill-intensive industries. Also, input markets such as land and labour are riddled with distortions. India has failed to show progress in social indicators or the Millennium Development Goals including environment. In this unit, you will study about the measures taken by the central bank to control inflation and its related effects in India.

9.1 OBJECTIVES

After going through this unit, you will be able to:

- Examine the price control mechanism used in the post-reform period in India
- Discuss the monetary and fiscal measures used to control inflation in India
- Define indexation

9.2 PRICE CONTROL MECHANISM IN THE POST - REFORM PERIOD

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Before the early 1990s (i.e., during the pre-reform period), major monetary instruments used by the RBI were direct methods such as interest rate regulations, selective credit controls and cash reserve ratio system so as to neutralize the monetary impact of the government's budgetary operations. The administered interest rate regime during that period kept the yield rate of government securities artificially low. Demand for these securities was created through increases in Statutory Liquidity Ratio (SLR).

To be more precise, the logical evolution of the monetary policy setting in India in the 1970s were in the direction of credit rationing as an internal element of developmental planning. The rationing of credit evolved with food credit being given the first charge, followed by the prescribed priority sector lending, sectoral limits for credit deployment and selective credit controls. Sectoral credit limits became the proximate targets for monetary policy which were operated through allocation of non-food commercial bank credit. Selective credit controls were strengthened by the institution of Credit Authorization Scheme in 1966–68. With the nationalization of banks, the institutional apparatus for conducting monetary policy through the credit channel, with the virtual exclusion of other channels, was complete. Refinance was provided in order to make up for the shortfall of credit targets in relation to demand. The interest rate structure was administered, rendering it inflexible and sterile as an instrument of monetary policy. The policy of setting up interest rate ceilings up to 1997–98 in situations of excess demand reinforced the rationing of bank credit in order to influence aggregate demand.

The situation during the post-reform period (since the early 1990s) has changed. The government securities were made market related. Also, an array of other market related products was created. Simultaneously, the interest rate structure was rationalized and deregulated. Banks were given a free hand in the determination of the major rates. These developments enable the RBI to make use of open market operations as an effective instrument for liquidity management. The impact of large capital inflows during this period has been sterilized through open market operations.

In short, the conduct of monetary management has undergone significant changes in the 1990s in terms of objectives, framework and instruments, reflecting broadly the progressive liberalization of the economy. The RBI announced a multiple indicator approach in 1998–99, which accord the necessary flexibility to respond to changes in domestic and international economic and financial market conditions more effectively. The monetary stance of the RBI in the recent period has been to ensure that all legitimate requirements for credit are adequately met without affecting adversely the objective of price stability.

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During the pre-reform period, the bank rate had only a limited role as an instrument of monetary policy. It was activated in 1997. Along with the Bank Rate, open market operations have also been actively used. With the stance of the RBI to move away from sector-specific refinance scheme, the liquidity in the system is managed through the 'liquidity adjustment facility' (LAF). The RBI influences liquidity on a day-to-day basis through this facility. The facility is being used as an effective flexible instrument for smoothening interest rates. The liquid adjustment facility has evolved as an effective mechanism for absorbing and/or injecting liquidity on a day-to-day basis in a flexible manner and, in the process, providing a corridor for the call money market and other short term interest rates. The operating procedures of the liquid adjustment facility are refined periodically to make it more efficient. As such, the repo and the reverse repo rates emerging from the LAF auctions essentially reflect the market conditions of availability of liquidity in the system along with the rate at which liquidity is available from the RBI.

The LAF operations coupled with judicious use of open market operations are expected to evolve into a principal operating procedure of monetary policy of the RBI. To this end, the RBI may have to reduce substantially the liquidity through refinance to banks and primary dealers. As cash reserve ratio gets lowered and repo market develops, the refinance facilities should also be lowered imparting more effectiveness to the conduct of monetary policy. The bank rate changes combined with cash reserve ratio and repo rate changes have emerged as signalling devices for interest rate changes and important tools of liquidity and monetary management.

Several landmark initiatives have been announced to make the conduct of monetary policy more effective. The decision to divest ownership functions in commercial banking, development of finance and securities trading activities, separation of supervisory functions in regard to cooperative banks, separation of public debt management functions from monetary policy, changes in operational conduct of monetary and fiscal policies suggested by Advisory Group on Transparency in Monetary and Fiscal Policies and the tabling of Fiscal Responsibility and Budget Management Legislation mark a new phase in the evolution of monetary policy in India in the new millennium.

As observed in the report on Currency and Finance 2000–01: 'The conduct of monetary policy in India would continue to involve the constant rebalancing of objectives in terms of the relative importance assigned, the selection of instruments and operating frameworks, and a search for an improved understanding of the working of the economy and the channels through which monetary policy operates'.

In conclusion, it may be observed that in the conduct of monetary policy, a number of common features could be identified. The more important among them are as follows:

1. There have been significant reductions in the reserve ratio to relieve the pressure on the banking sector and reduce the costs of intermediation.

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As a matter of fact, many countries now have no reserve requirements. And, in some countries, the level of minimum deposit at the central bank has fallen to such low levels that it is no longer considered to be an active monetary policy instrument.

2. The deepening of financial markets and the growth of non-bank intermediation has induced the central banks to increase the market orientation of their instruments. A consequence of this is greater activism of central banks in liquidity management.
3. The greater activism through indirect instruments led to more intensive use of open market operations through flexible instruments like repo. The open market operations can be used for net injection or absorption of liquidity and can be resorted to irrespective of whether the operating target works through the rate channel or quantity channel.
4. The market environment has induced many central banks to focus more on the interest rates rather than bank reserves in trying to influence liquidity.

Check Your Progress

1. Why was a multiple indicator approach announced by the RBI in 1998-99?
2. List any two common features that have been identified in the conduct of the monetary policy of India.

9.3 CONTROL MEASURES

Economists agree that inflation beyond a moderate rate is bad and can often prove disastrous and, therefore, it must be kept under control. The various measures suggested for controlling inflation can be classified under (*i*) monetary measures, (*ii*) fiscal measures, (*iii*) price and wage control, and (*iv*) indexation.

9.3.1 Monetary Measures

Monetary measures which are widely used to control inflation include (*i*) bank rate policy, (*ii*) variable reserve ratio, and (*iii*) open market operation.

(*i*) **Bank Rate Policy:** Bank rate or, more appropriately called, 'Central Bank rediscount rate', is the rate at which central bank buys or rediscounts the eligible bills of exchange and other approved commercial papers presented by the commercial banks for building reserves. The central bank performs this function as the 'lender of the last resort.' In general, bank rate policy is used even during the period of inflation as the main instrument of monetary control. The use of bank rate policy forms the basis of 'dear money' or 'tight money' policy and the 'cheap money policy' depending on the need

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of the country. When the central bank raises the bank rate, it is said to have adopted a 'dear money policy'.

The bank rate as a measure of inflation control works in two ways. *One*, during the period of inflation, the central bank raises the bank rate. This increases the cost of borrowing which reduces commercial banks' borrowing from the central bank. This reduces banks' ability to create credit through the process of credit multiplier. As a result, flow of money from the commercial banks to the public gets reduced. Therefore, inflation is controlled to the extent it is caused by the bank credit. *Two*, bank rate sets the trend for the general market rate of interest, particularly in the short-term money market. If bank rate is increased with a view to controlling money supply and, thereby, inflation, commercial banks increase their lending rates and other market rates follow the suite. In general, the cost of borrowing goes up. This slows down the monetary flows to the society.

This method, however, does not work effectively, if (*i*) commercial banks have excess liquidity, (*ii*) they have alternative sources of creating reserves, (*iii*) they are free not to raise their lending rates following the increase in the bank rate, and (*iv*) future expectations regarding the market prospects is optimistic.

In India, the RBI is constrained to make full use of the bank rate policy as an instrument of monetary control for the fear of (*i*) that it might raise the interest rate in the gilt-edged market and thereby increase government's cost of borrowing, and (*ii*) that it might result in capital loss to the bond-holders, the financial institutions. 'The role of the bank rate as an instrument of monetary policy has been very limited in India, because of a number of factors like the administered structure of interest rates, sector specific refinance facilities for commercial banks and underdeveloped bill market' (*Economic Survey, 1994–95*, Government of India, p. 43).

(*ii*) **Variable Reserve Ratio:** Commercial banks are required to maintain a certain proportion of their total demand and time deposits in the form of *cash reserves,* called **cash reserve ratio (*CRR*).** The cash reserve ratio (*CRR*) is generally determined and imposed by the central bank which it uses as a weapon to control money supply. To control inflation, the central bank rises the *CRR*. When central bank raises the *CRR*, it reduces the lending capacity of the commercial banks. As a result, flow of money from the commercial banks to the public decreases. In the process, it halts the rise in prices to the extent it is caused by the banks credits to the public. This method of monetary control or controlling inflation has the same limitations as the bank rate policy.

(*iii*) **Open Market Operations:** Open market operations refer to sale and purchase of the government securities and bonds by the central bank. To control inflation, central bank sells the government securities to the public

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through the authorized commercial banks. The sale of government bonds through the banks reduces credit creation capacity of the commercial banks because it reduces their total deposits. Therefore, money supply with public is reduced a multiple of sale proceeds of the treasury bills through a process of reverse money multiplier. As a result, inflation is controlled to the extent money supply with public decreases.

Open market operation is regarded an efficient instrument of monetary control in the developed countries like the USA and the UK. This method is more effective than other methods of monetary control. In the developing countries like India, however, open market operation has not proved very successful mainly because treasury bill market is not developed and well organized. In India, treasury bill market is not well developed. It is largely a captive-market confined to the financial institutions such as scheduled commercial banks, life insurance and general insurance companies, and the government financial corporations. These institutions are required by law to invest a certain proportion of their total liabilities in the government bonds and securities. The treasury bill market in India is therefore said to be a 'captive market'.

9.3.2 Fiscal Measures

Fiscal measures to control inflation include *taxation, government expenditure* and *public borrowings.* Keynesian economists, also called 'fiscalists', argue that demand-pull inflation is caused by excess of aggregate demand over aggregate supply. The excess demand is the result of increase in expenditure by the households, firms and the government, particularly by excessive spending by government. Excess demand, be it household or government expenditure it can be effectively controlled by fiscal measures. Therefore, fiscal policy or the budgetary measures are a more powerful and effective weapon to control demand-pull inflation.

In case *government expenditure* is the cause of excess demand, it can be controlled straightaway by cutting down public expenditure. A cut in public expenditure reduces government demand for goods and services and also the private consumption expenditure arising out of government expenditure multiplier. Therefore, the excess demand decreases more than a given cut in public expenditure. And, in case excess demand is caused by rise in private expenditure, *taxing incomes* is a more appropriate measure to control inflation. Taxation of incomes reduces the disposable income of the people and thereby consumer demand.

In case of a very high rate of persistent inflation, the government may adopt both the measures simultaneously. It should cut down its own spending, on the one hand, and increase the rate of income taxation, on the other. This kind of policy is known as a **policy of surplus budgeting,** *i.e.*, the government should spend less than its tax revenue.

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Is Fiscal or Monetary Policy More Effective in Controlling Demand-pull Inflation?

Whether fiscal or monetary policy is more effective in controlling demand-pull inflation or any kind of inflation has been a matter of controversy and prolonged debate between the fiscalists and monetarists. Fiscalists argue that fiscal policy is more effective in controlling inflation whereas monetarists argue that monetary policy is a more effective weapon than the fiscal measures to control inflation. Economists called 'rationalists' and 'supply-siders' hold a different view from those of the monetarists and fiscalists on the measures to control inflation. Empirical evidence on the relative effectiveness of monetary and fiscal policies are not conclusive either. Some economists, viz., Andersen and Jordan, find in their researches monetary policy more effective than the fiscal policy in controlling inflation and promoting employment. Some other economists, viz., Leeuw and Kalchbrenner, find that fiscal policy is more effective than the monetary policy. Findings of Gary Fomm and R. Klien support the view that fiscal policy is more effective. Most researches on this issue find that fiscal policy is more effective, but they do not prove conclusively that monetary policy is not effective.

However, it may be suggested that if inflation is caused by the monetary factors, say, due to excess money supply, then monetary policy would be more effective. And, if inflation is caused by real factors, *e.g.*, due to rise in the household demand and public expenditure, then fiscal policy would be more effective. In fact, an appropriate combination of fiscal and monetary policy is more effective in controlling inflation than any of these policies.

9.3.3 Price and Wage Control

Where monetary and fiscal measures prove ineffective in controlling inflation, direct control measures are adopted to control inflation. Direct measures consist mainly of price and wage controls. The price and wage controls go together because price-push and cost-push inflation go hand in hand whatever may be the cause of initial inflation.

Under **price control method,** a maximum retail price of goods and services is fixed. Price control may be general, applicable to all goods and services or it may be partial confined to only scarce and essential goods and services. The primary objective of price control is to prevent the price rise of scarce goods and to ration the use of the commodity. Whether price control works effectively and efficiently is a controversial matter. It is a general experience that price controls lead to black-marketing of goods and unfair distribution of scarce goods and services, especially where administrative machinery is corrupt and inefficient.

Wage control is used where inflation is of *cost-push* or of *wage push nature.* Under this method, rise in wage rate is prevented directly by imposing a ceiling on the wage incomes in both private and public sectors. Often 'wage-freeze' is applied to control inflation. In case trade unions are powerful and oppose

'wage-freeze' effectively, government uses a weaker method called '**jawboning'**. A more sensible and effective method of containing wage-push inflation is known as '**wage guideposts'**— a plan of action against inflation prepared by common consent and mutual agreement between the representatives of the government, trade unions and the businessmen, for a disciplined and controlled upward movement in the wages and prices. Under this scheme, wage and price rise are monitored by a board of the representatives. However, this method does not work for long, especially when prices continue to rise. Friedman comments, "Guideposts and pleas for voluntary compliance are a halfway [measure] whose only merit is that they can more readily be abandoned than legally imposed controls. They are not an alternative to other effective measures to stem inflation, but at most a smoke-screen to conceal lack of action.'

9.3.4 Indexation

It should be clear from the foregoing discussion that inflation is an intractable problem. Controlling inflation involves the risk of aggravating unemployment problem. However, as discussed above, a high rate of inflation affects different sections of the society in different ways. Economists argue that if controlling inflation is not advisable, its adverse effects on different sections of society can be minimized by a method called **indexation**. They suggest that indexation of prices, wages and contractual obligations with a view to compensating those who lose their real incomes due to inflation. According to Samuelson and Nordhaus, '**Indexing** is a mechanism by which wages, prices and contracts are partially or wholly compensated for changes in the general price level'. Thus, indexation is not a method of controlling inflation. It is a method of adjusting monetary incomes so as to minimize the undue gains and losses in real incomes of the different sections of the society due to inflation. Its main objective is to manage social discontent. Its objective is to make inflation easier to live with.

Indexation of wages is most important and a common practice in many countries where wage contracts are long-term contracts and inflation continues to persist. In such cases, compensating workers for the loss of their real income due to inflation becomes unavoidable. Two systems are adopted in general: *one* is to tie wages to cost-of-living index (*CPI*), and *second* is to make a periodic scheduling of wage rise after *CPI* goes up by a certain percentage point. For instance, in the USA, wages are linked to cost-of-living index and cost-of-living adjustment (*COLA*) with inflation is made automatic. Here, wages increase automatically following the increase in the cost-of-living index. In India, wage compensation takes the form of 'dearness allowance', *i.e.*, compensation for loss of purchasing power of the nominal wages due to inflation. Dearness allowance to the public sector employees in India is linked to consumer price index (*CPI*) and dearness allowance is granted after every 8 percentage point increase in the *CPI*.

Although economists strongly recommend indexing of wages, debts, taxes, and all other long-term contractual payments, the governments doubt the *feasibility*

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and practicability of indexation method for three reasons. *One*, adjustment in indexation is impracticable in case of frequent supply shocks of great amplitude. *Second*, economy being a complex system with interlinked and interrelated prices, a reasonable indexing of all prices to the satisfaction of all concerned is an extremely difficult task. *Third*, the government find indexation politically undesirable because it does not control inflation, it rather creates a base for its perpetuation.

Check Your Progress

3. Name the measures which help in controlling inflation.
4. What do you understand by the term 'open market operation'?

9.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A multiple indicator approach was announced by the RBI in 1998–99 to accord the necessary flexibility to respond to changes in domestic and international economic and financial market conditions more effectively.
2. Two common features that have been identified in the conduct of the monetary policy of India are as follows:
   i. There have been significant reductions in the reserve ratio to relieve the pressure on the banking sector and reduce the costs of intermediation. As a matter of fact, many countries now have no reserve requirements. And, in some countries, the level of minimum deposit at the central bank has fallen to such low levels that it is no longer considered to be an active monetary policy instrument.
   ii. The deepening of financial markets and the growth of non-bank intermediation has induced the central banks to increase the market orientation of their instruments. A consequence of this is greater activism of central banks in liquidity management.
3. The various measures suggested for controlling inflation can be classified under (*i*) monetary measures, (*ii*) fiscal measures, (*iii*) price and wage control, and (*iv*) indexation.
4. Open market operations refer to sale and purchase of the government securities and bonds by the central bank. To control inflation, central bank sells the government securities to the public through the authorized commercial banks. The sale of government bonds through the banks reduces credit creation capacity of the commercial banks because it reduces their total deposits.

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9.5 SUMMARY

- Before the early 1990s (i.e., during the pre-reform period), major monetary instruments used by the RBI were direct methods such as interest rate regulations, selective credit controls and cash reserve ratio system so as to neutralize the monetary impact of the government's budgetary operations.
- The situation during the post-reform period (since the early 1990s) has changed. The government securities were made market related. Also, an array of other market related products was created. Simultaneously, the interest rate structure was rationalized and deregulated.
- During the pre-reform period, the bank rate had only a limited role as an instrument of monetary policy. It was activated in 1997. Along with the Bank Rate, open market operations have also been actively used.
- The LAF operations coupled with judicious use of open market operations are expected to evolve into a principal operating procedure of monetary policy of the RBI. To this end, the RBI may have to reduce substantially the liquidity through refinance to banks and primary dealers.
- Economists agree that inflation beyond a moderate rate is bad and can often prove disastrous and, therefore, it must be kept under control. The various measures suggested for controlling inflation can be classified under (*i*) monetary measures, (*ii*) fiscal measures, (*iii*) price and wage control, and (*iv*) indexation.
- Commercial banks are required to maintain a certain proportion of their total demand and time deposits in the form of *cash reserves,* called cash reserve ratio (*CRR*).
- Open market operations refer to sale and purchase of the government securities and bonds by the central bank. To control inflation, central bank sells the government securities to the public through the authorized commercial banks. The sale of government bonds through the banks reduces credit creation capacity of the commercial banks because it reduces their total deposits.
- Fiscal measures to control inflation include *taxation, government expenditure* and *public borrowings.* Keynesian economists, also called 'fiscalists', argue that demand-pull inflation is caused by excess of aggregate demand over aggregate supply.
- Where monetary and fiscal measures prove ineffective in controlling inflation, direct control measures are adopted to control inflation. Direct measures consist mainly of price and wage controls. The price and wage controls go together because price-push and cost-push inflation go hand in hand whatever may be the cause of initial inflation.

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- Wage control is used where inflation is of *cost-push* or of *wage push nature.* Under this method, rise in wage rate is prevented directly by imposing a ceiling on the wage incomes in both private and public sectors.
- Indexation of wages is most important and a common practice in many countries where wage contracts are long-term contracts and inflation continues to persist. In such cases, compensating workers for the loss of their real income due to inflation becomes unavoidable.

9.6 KEY WORDS

- **Statutory Liquidity Ratio (SLR):** Statutory Liquidity Ratio is the Indian government term for reserve requirement that the commercial banks in India require to maintain in the form of gold, government approved securities before providing credit to the customers.
- **Cash Reserve Ratio (CRR):** Cash reserve Ratio is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank.
- **Repo rate:** Repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. Repo rate is used by monetary authorities to control inflation.
- **Central Bank rediscount rate:** It is the rate at which central bank buys or rediscounts the eligible bills of exchange and other approved commercial papers presented by the commercial banks for building reserves.

9.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What were the major monetary instruments used by the RBI during the pre-reform period in India?
2. Write a short note on the control mechanism used by the RBI in the post-reform period in India.
3. Briefly mention the fiscal measures used to control inflation in India.

Long-Answer Questions

1. Discuss the monetary measures used to control inflation in India.
2. 'Indexation of wages is most important and a common practice in many countries.' Explain the statement.
3. 'Wage control is used where inflation is of cost-push or of wage push nature.' Do you agree with this statement? Give reasons for your answer.

9.8 FURTHER READINGS

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UNIT 10 MONETARY POLICY IN INDIA

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Structure

10.0 INTRODUCTION

Monetary policy refers to the policy of the central bank with regard to the use of monetary instruments under its control to achieve the goals specified in the Act. The Reserve Bank of India (RBI) is vested with the responsibility of conducting monetary policy. This responsibility is explicitly mandated under the Reserve Bank of India Act, 1934. The Monetary Policy Committee (MPC) constituted by the Central Government under Section 45ZB determines the policy interest rate required to achieve the inflation target. In this unit, you will study about the meaning, importance and effects of monetary policy of India.

10.1 OBJECTIVES

After going through this unit, you will be able to:

- List the significant features of India's monetary policy
- Examine the importance of monetary policy of India

10.2 MONETARY POLICY: IMPORTANCE AND EFFECTS

Money is one of the greatest inventions of mankind and the existence of a monetary economy has done much to enhance the material welfare of the human race. Yet in actual operation it has become more and more painfully evident that money does not always perform its functions properly. Refusing to remain as a useful slave, money has often behaved as a tyrant imposing arbitrary redistribution of wealth and income among the various classes of people. It has, therefore, been felt that money should be made to behave properly. This raises the question of defining the

ideal behaviour of money. Once we can define this ideal behaviour of money, the problem of defining monetary policy becomes easy.

NOTES

The term monetary policy is used to denote the policy of the government regarding money matters. The government must determine the objectives of monetary management.

1. **Falling Price Level:** Marshall showed preference for a falling price-level. Periods of rising prices contain within themselves seeds of future disasters. With falling prices, though the businessmen get less, the wage-earners get more. In a progressing economy, a slowly falling price level may be the ideal monetary policy so that the benefits of economic progress might be enjoyed by all those whose money incomes are fixed by contract or customs.
2. **Stable Price Level:** Rising prices and falling prices are both bad and therefore, the stable prices are the best. Since money is a store of value, variations in its value cause unnecessary loss or confer unfair advantages both of which are against the principle of natural justice. Moreover, stable price would secure social justice; it would ensure justice between debtors and creditors and between wage earners and employers.
3. **Generally Rising Price Level:** The case in favour of a slowly rising price level rests on the fact that it acts as a great incentive to enterprise. When prices rise, the expenses of businessmen do not rise as much as prices. Hence, during such periods businessmen can make huge profits. Prospects of profits would stimulate them to increase production. Thus, rising prices would secure full employment of workers than could otherwise be obtained. In a community characterized by varying degrees of unemployment, a slowly rising price level may be, as Keynes observed, a better monetary policy than mere price stability. According to Robertson, industrial progress in the nineteenth century has been made possible because of the stimulus given by rising prices.

   Rising prices conflict with the principle of social justice. Periods of rising prices lower the real value of money incomes of wage earners and the investing classes. It is not desirable that wage earners should be made to suffer in order to provide incentive to businessmen. Moreover, rising price might lead to overinvestment, speculative boom and ultimate collapse.
4. **Neutral Money:** In view of the defects of stable prices, Prof. Hayek has proposed that the ideal monetary policy is that which interferes as little as possible with the operation of non-monetary forces. When there is no money and the barter system prevails, ratios of exchange would be established between different goods. The aim of monetary policy is to see that the same ratios of exchange prevail even under money

economy. The introduction of money should not 'distort' the situation that should have obtained under barter. In other words, money should be neutral in its effects on prices. This could be secured not by stability of prices, but by the stability in the quantity of money in circulation.

5. **Avoidance of Cyclical Fluctuations:** Many economists are of opinion that business fluctuations are caused by monetary factors and can be remedied by monetary weapons. Bank credit can be regulated by the Central Bank by variation of bank rate, open market operations, etc. Through these weapons, the central bank can restrict credit to choke off a boom and expand credit to avoid recessions. However, according to Keynes, business cycles are not caused by monetary factors, and hence, purely monetary weapons cannot prevent them. Although, monetary policy can reduce the range of business fluctuations—make booms and slumps less severe.
6. **Stability of External Value of Currency:** The monetary policy of a country must aim at securing stability of the rate of foreign exchange. Stable exchange rates are highly important for countries like UK whose economic prosperity depends upon foreign trade. The pre-war gold standard was managed for the purpose of securing exchange stability. Stability of exchange rates secured large benefits for the world. It facilitated large-scale movements of goods from one country to another. It also fostered the growth in the volume of international investment. However, stability in the rate of foreign exchange at the cost of internal price stability is not desirable. Nowadays, exchange stability is secured through exchange control. Exchange stability is not inconsistent with internal price stability. The external and internal values of money are two aspects of the same thing. There is no reason why both cannot be kept stable by efficient management.
7. **Full Employment and High Rate of Economic Growth:** The objective of monetary policy should be full employment of all available resources and a high rate of economic growth. If private expenditure is not adequate to achieve and maintain full employment, the deficiency must be made up by public expenditure. There will be no inflation so long as there are unemployed resources, which interfere as little as possible with the operation of non-monetary forces. When there is no money and the barter system prevails, ratios of exchange would be established between different goods. The aim of monetary policy is to see that the same ratios of exchange prevail even under money economy. The introduction of money should not 'distort' the situation that should have obtained under barter. In other words, money should be neutral in its effects on prices. This could be secured not by stability of prices, but by the stability in the quantity of money in circulation. If the supply of

effective money is kept constant then there can be no distortion of the real ratios of exchange through changes in the quantity of money. The price level would then vary inversely with productive power.

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Importance and Effects

- Monetary policy is important for the regulation of the banking system in the economy.
- It helps in the regulation of money supply as well as stocks.
- It helps in the determination of how much loan is to be allocated for different sectors of the economy.
- It assists in the achievement of price stability.
- It is useful to maintaining an appropriate level of credit for growth of the economy.
- It helps in the promotion of savings.

Check Your Progress

1. Why is it necessary to stabilize prices in view of monetary management in India?
2. What is the significance of the stability of exchange rate?

10.3 EFFECTS OF MONETARY POLICY IN INDIA

There appears to be a general consensus today that the primary objective of monetary policy should be domestic price stability. Maintenance of price stability and ensuring availability of adequate credit to the productive sectors of the economy are the major objectives of the monetary policy in India. The stated objectives of monetary policy in India are 'to promote sufficient credit for growth while ensuring that there is no emergence of inflationary pressures on this account'. The relative emphasis between the objectives depends on the underlying economic conditions and is spelt out from time to time. As far as inflation is concerned, as compared to many other developing countries, India has been able to maintain a moderate level, and inflation rates in India rarely touched double digit.

Although, the policy objectives of the Reserve Bank of India remained broadly unchanged over the years, there is some change in emphasis from time to time. In addition to the traditional objectives of growth and price stability, a third objective that has been gaining importance in the post-reform period is that of financial stability. While in the short run, there may exist some trade-off between the stated objectives, in the long run, the complementarities among them became more pronounced. The focus on growth and stability continues to be reflected in the overall stance of monetary policy in recent years. The policy statements as

NOTES

well as mid-term reviews of the RBI have been focussing on the structural and regulatory measures to strengthen the financial system. The policy measures have been guided by the objectives of increasing operational efficiency of monetary policy, redefining the regulatory role of the RBI, strengthening prudential norms, and developing technological and institutional infrastructure. It may be noted in this connection that the policy statements of the RBI provide a framework for the monetary, structural and prudential measures that are initiated from time to time consistent with the overall objectives of growth, price stability and financial stability. In recent years, monetary management had to be constantly fine-tuned to keep pace with the fast evolving changes, accentuated by growing sophistication of financial markets and integration of domestic economy with the international economy.

10.3.1 Report of the Working Group to Review the Framework of the Operating Procedure of Monetary Policy

The RBI announced the constitution of the Working Group to review the framework of the operating procedure of monetary policy in India in the First Quarter Review of Monetary Policy for 2010–11. On the basis of a survey of country practices and technical evaluation of the evolution of the current monetary operations in the RBI, the Group made the following key recommendations:

- The liquidity adjustment facility (LAF) with some modifications to be the key element in the operating framework of the RBI.
- The modified LAF should operate in a deficit liquidity mode and the liquidity level should be contained around (+)/(-) one per cent of net demand and time liabilities (NDTL) of banks for optimal monetary transmission.
- The repo rate should be the single policy rate to unambiguously signal the stance of monetary policy to achieve macro-economic objectives of growth with price stability. It will operate within a corridor set by the bank rate and the reverse repo rate. As the repo rate changes, the bank rate and the reverse repo rate should change automatically.
- The RBI at its discretion could conduct simultaneous auctions for longer period if the liquidity situation so warrants. However, such actions should be at variable prices as they will be for purely liquidity management rather than for signaling the policy rate.
- The bank rate should be reactivated as a discount rate as envisaged in the Reserve Bank of India Act, 1934. It will be the rate at which the RBI will provide liquidity under a new collateralised Exceptional Standing Facility (ESF) up to one per cent of NDTL of banks to be carved out of the required Statutory Liquidity Ratio (SLR) portfolio. The bank rate will constitute the upper bound of the corridor.

NOTES

- The reverse repo rate will have a negative spread on the repo rate and it will be the rate at which the RBI will absorb liquidity under the LAF. The reverse repo rate will constitute the lower bound of the corridor.
- The optimal width of the policy corridor be fixed at 150 basis points and should not be changed in the normal circumstance. The corridor should be asymmetric with the spread between the policy repo rate and reverse repo rate twice as much as the spread between the repo rate and the bank rate. With a corridor of 150 basis points, the bank rate could be fixed at repo rate plus 50 basis points and the reverse repo rate at repo rate minus 100 basis points.
- The weighted average overnight call money rate to be the operating target of the RBI. The operating objective should be to contain this rate around the repo rate within the corridor.
- The Reserve Bank should conduct the second LAF (SLAF) on a regular basis.
- Persistent liquidity in excess of (+)/(-) one per cent of the NDTL should be managed through other instruments such as outright Open Market Operations (OMO), Cash Reserve Ratio (CRR) and Market Stabilisation Scheme (MSS).
- Banks should be incentivised to progressively mark-to-market their SLR portfolio to improve the use of OMO as an instrument of liquidity management. The group recognises that in due course, the accounting standard shall get aligned with the International Financial Reporting Standards (IFRS).
- To improve liquidity management, a scheme of auctioning of government surplus cash balance at the discretion of the RBI to be put in place in consultation with the government.
- Collateral pool for reverse repo operation under LAF could be extended to include oil bonds.
- The methodology for the RBI's internal liquidity forecast should be strengthened. Information on government cash balances be put in the public domain with the minimum time lag for better liquidity assessment by market participants.
- The minimum level of reserves to be maintained on any day by banks with the RBI during a fortnight be raised from the present level of 70–80 per cent of the required CRR.
- The T+0 transactions for short-term money market segments Collateralised Borrowing and Lending Obligations (CBLO) and market repo should be extended up to the cut-off timing for customers in Real Time Gross Settlement (RTGS) (i.e., 4.30 PM) so that the banking system could square off their CRR position efficiently.

Changes in the Operating Procedure of Monetary Policy

Based on the report of the Working Group on Operating Procedure of Monetary Policy, the Reserve Bank made a number of changes in the operating procedure of monetary policy with effect from May 2011. As per these changes, the weighted average overnight call money rate was made the operating target of monetary policy. Further, the repo rate was made the single policy rate to more accurately signal the monetary policy stance with the reverse repo rate pegged at a fixed 100 basis points below the repo rate. A new Marginal Standing Facility (MSF) was also instituted under which Scheduled Commercial Banks (SCBs) could borrow overnight up to one per cent of their respective Net Demand and Time Liabilities (NDTL), carved out of the required Statutory Liquidity Ratio (SLR) portfolio. The MSF rate is 100 basis points above the repo rate and provides an upper bound to the policy rate corridor with reverse repo rate as the lower bound. These changes were deemed necessary for improved liquidity management and effective monetary transmission.

As of 6th March 2020, the key indicators are as follows:

- Inflation: 5.5 per cent
- Bank rate: 5.40 per cent
- Cash reserve ratio (CRR): 4 per cent
- Statutory liquidity ratio (SLR): 18.25 per cent
- Repo rate: 5.15 per cent
- Reverse repo rate: 4.90 per cent
- Marginal standing facility rate: 5.40 per cent

Monetary Policy Making Process

In this context, it would be enlightening to have a brief idea on the process of monetary policy making in India, especially in order to get an idea as to the extent to which India complies with international standards and codes in the area of transparency in monetary and fiscal policies.

The process of making monetary policy in India is an elaborate one and there are a number of technical, analytical, institutional and dynamic inputs that go into the process. At the apex of making monetary policy making process is the Governor of the RBI, assisted by Deputy Governors and guided by deliberations of the Board of Directors. Monetary, economic and financial conditions are reviewed every week by a Committee of the Board of Directors so that advices are given or decisions are taken appropriately. There are Standing and Ad-hoc Committees or groups of the Board of Directors and Board for Financial Supervision as well, which play a critical role in regard to institutional developments. Periodical consultations with academics, market participants and financial intermediaries take place through Standing Committees and Ad-hoc groups, in addition to mechanisms

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such as resource management discussions with banks. Financial Markets Committee focusses on day-to-day market operations and tactics while a Monetary Policy Strategy Group analyses strategies on an on-going basis. In order to ensure coordination, periodical consultations with the government, mainly with Ministry of Finance, are made.

The stance on monetary policy and the rationale are communicated to the public mainly through the annual policy statement by the Governor of the RBI in April and the mid-term review in October. These statements are analytical, at times introspective and elaborate.

As part of the process of reforms, one of the Advisory Groups with Shri M. Narasimham as Chairman assessed the extent to India's compliance with international standards and codes in the area of 'Transparency in Monetary and Fiscal Policies'. The group, while noting that the policies and operations of the RBI largely conform to the IMF Code, made a set of recommendations for making India fully compliant with the Code. The main points covered in the recommendations and the follow-up actions in relation to them are summarized as follows:

1. The objective of monetary policy should be set out by the government, as part of its overall economic policy package, and the government should be obliged to seek parliamentary debate on these objectives as also any changes in these objectives thereafter. The government should also consider prescribing to the RBI single objective such as medium term inflation while the government would have for itself a clearly set out hierarchy of objectives for which it could use other instruments of policy.

   In relation to this recommendation, the RBI is of the view that at the current stage of institutional development and fiscal stance, coordination and harmony are of paramount importance though there is need for clear demarcation of responsibilities and accountability between the RBI and the government with appropriate degrees of transparency. Moving in this direction, the RBI is divesting all ownership functions in commercial banks as also term lending institutions, subject to approval by the government.

2. Amendment to relevant legislation to accord greater operational flexibility to the RBI for the conduct of monetary policy and regulation of the financial system.

   The RBI has transmitted proposals for legislative changes in the RBI Act, which is under consideration of the government. These proposals, if endorsed by the Parliament, would accord greater operational flexibility to the RBI for conduct of monetary policy.

3. The government should set up its own independent debt management office to take over the functions being discharged by the RBI in order to avoid conflict of interest in conduct of monetary policy.

An enabling proposal to delink the function of debt management of the government from the RBI has been made in the Reserve Bank of India (Amendment) Bill, 2001. The government has decided, in principle, to delink these functions.

4. The RBI should set up a Monetary Policy Committee as a Committee of the Board of Directors, requiring no specific changes in the law.

In relation to this recommendation, the RBI has not taken any view. However, it needs to be noted that, as mentioned earlier, the transparency and consultative process in the RBI have been deepened and widened significantly in recent years.

The reconstituted Technical Advisory Committee on Monetary Policy (TACMP) with tenure up to January 2009 has strengthened the consultative mechanism for monetary policy in India as important issues are discussed in its meeting held from time to time. TACMP's role is, however, advisory in nature and the responsibility and accountability of the decision-making rests with the RBI. The Committee is headed by the RBI Governor with the Deputy Governor in charge of monetary policy as Vice-Chairman and comprises the other three Deputy Governors, two members of the Central Board of the RBI and five external members with expertise in the areas of monetary economics, central banking, financial markets and public finance.

Conclusion

The interest rate regime is made more flexible and responsive to economic fundamentals. The interest rate policy is evolving and at the present stage of development, it may not be as effective as it could be in more deregulated environment mainly because the financial markets lack depth and far from being fully integrated. Moreover, the public sector dominates the financial sector. This has a tendency to impede responses based on either market considerations or regulatory incentives. In the context of deceleration in industrial activity, the role of monetary policy in enabling the revival by marking down interest rates has been widely discussed. In this context, it is worth noting that the RBI has created a number of instruments, as a package, to ensure adequate liquidity and appropriate interest rates. Allowing for lending below prime lending rates (PLR), for instance, has resulted in a significant amount of lending at sub-PLR rates.

In recent years, the operating procedures of monetary policy have undergone significant changes. A major transformation has also taken place in the form of an expansion in the array of monetary instruments. The gradual switch over to indirect market-based instruments in the conduct of monetary policy was made possible because of simultaneous efforts at developing various segments of the financial market, particularly money, foreign exchange and government securities market. Reforms in the call money market when fully implemented in the next few years would mean completion of transition towards indirect instruments of monetary policy. The increasing responsibility of the RBI in undertaking reform in the financial

NOTES

market is to be seen essentially in the context of improving the effectiveness of the transmission channels of monetary policy. Development of financial markets has, therefore, encompassed regulatory and legal channels, building up of institutional infrastructure, constant fine tuning in market microstructure and massive upgradation of technological infrastructure. An important development in the evolution of monetary policy in India is the activation of the bank rate as an instrument of monetary policy in 1997. This was followed-up with a more active recourse to repo operations, leading to an orderly progress to a full-fledged liquid adjustment facility. With the emergence of financial markets with depth and sophistication, the bank rate would perform the critical function of the principal signalling variable and the LAF rates, setting a corridor for short-term money market, would be the operating instruments of monetary policy.

Against the backdrop of risks to inflation and inflationary expectations because of upside pressures from international food and energy prices, the Annual Policy Statement for the year 2008–09 emphasized that the stance of monetary policy was geared towards maintenance of monetary and interest rate environment that accorded high priority to price stability, well-anchored inflation expectations and orderly conditions in financial markets while being conducive to continuation of growth momentum. In accordance with the policy stance, it was reiterated that the RBI would continue with its policy of active demand management of liquidity through appropriate use of the cash reserve ratio (CRR) stipulations and open market operations, including the market stabilization scheme and the liquidity adjustment facility (LAF), using all the policy instruments at its disposal flexibly, as and when warranted by the situation.

RBI Monetary Policy: The Reserve Bank of India on 6 February 2020 released the Sixth Bi-monthly Monetary Policy Statement 2019-20. The RBI's Monetary Policy Committee (MPC) after assessing the current macroeconomic situation, announced to keep the policy Repo Rate unchanged at 5.15 per cent. The MPC decided to continue with the accommodative stance to revive the growth of Indian Economy and to maintain the inflation rate within the target.

With Repo Rate being unchanged, the Reverse Repo Rate too remains the same at 4.9 per cent. The Marginal Standing Facility (MSF) & Bank Rates stood at 5.4 per cent. Besides this, the MPC undertook several measures to boost the economy and encourage demand.

The following are the key policy decisions announced by the Committee in the policy statement along with the observations made in fiscal 2019-20.

Highlights of the 6th Bi-Monthly Monetary Policy 2019-20

- Inflation increased due to the unexpected price hike of onions.
- Retail Inflation hiked to 7.4 per cent in December 2019 from 5.5 per cent in November 2019 and 4.6 per cent in October 2019. The Retail Inflation was the highest since July 2014.

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- The Policy estimates the CPI Inflation for the Q4 of 2019-20 at 6.5 per cent.
- The slowdown in the Indian Economy has been attributed to weak corporate investments, decline in demand in real estate & automobile sector, and poor household spending.
- Doing away with CRR for MSMEs: The Policy asks Banks to not apply CRR Restrictions on any incremental Housing/Automobile/MSMEs loans during January 2020 - July 2020.
- One-time Restructuring Scheme extended for MSME loan: MSMEs which began defaulting from January 1, 2020 can now restructure their loans till December 31, 2020.
- Banks to benchmark Retails Loans to"MSMEs" at Repo Rate: The Policy brings down the rate at which Banks used to lend to Micro, Small and Medium Enterprises (MSMEs). Now, even Medium-sized enterprises will be sanctioned loans at Repo Rate; earlier, this facility was enjoyed only by micro and small enterprises. This could make Home & auto loans cheaper.
- To help boost the real estate sector, the Policy says that the real estate projects which have been delayed beyond the control of borrowers will get additional 1 year to carry out commercial operations. Such loan accounts will not be termed as NPAs.

Check Your Progress

3. What are the major objectives of the monetary policy in India?
4. List any two major features of the sixth bi-monthly monetary policy 2019-2020.

10.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Rising prices and falling prices are both bad and therefore, the stable prices are the best. Since money is a store of value, variations in its value cause unnecessary loss or confer unfair advantages both of which are against the principle of natural justice. Moreover, stable price would secure social justice; it would ensure justice between debtors and creditors and between wage earners and employers.
2. Stability of exchange rates secured large benefits for the world. It facilitated large-scale movements of goods from one country to another. It also fostered the growth in the volume of international investment. Nowadays, exchange stability is secured through exchange control.

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3. There appears to be a general consensus today that the primary objective of monetary policy should be domestic price stability. Maintenance of price stability and ensuring availability of adequate credit to the productive sectors of the economy are the major objectives of the monetary policy in India.
4. Two major features of the sixth bi-monthly monetary policy 2019-2020 are as follows:
   i. Retail Inflation hiked to 7.4 per cent in December 2019 from 5.5 per cent in November 2019 and 4.6 per cent in October 2019. The Retail Inflation was the highest since July 2014.
   ii. The Policy estimates the CPI Inflation for the Q4 of 2019-20 at 6.5 per cent.

10.5 SUMMARY

- Money is one of the greatest inventions of mankind and the existence of a monetary economy has done much to enhance the material welfare of the human race. Yet in actual operation it has become more and more painfully evident that money does not always perform its functions properly.
- Rising prices and falling prices are both bad and therefore, the stable prices are the best. Since money is a store of value, variations in its value cause unnecessary loss or confer unfair advantages both of which are against the principle of natural justice.
- Many economists are of opinion that business fluctuations are caused by monetary factors and can be remedied by monetary weapons.
- The monetary policy of a country must aim at securing stability of the rate of foreign exchange. Stable exchange rates are highly important for countries like UK whose economic prosperity depends upon foreign trade.
- The objective of monetary policy should be full employment of all available resources and a high rate of economic growth.
- There appears to be a general consensus today that the primary objective of monetary policy should be domestic price stability. Maintenance of price stability and ensuring availability of adequate credit to the productive sectors of the economy are the major objectives of the monetary policy in India.
- The process of making monetary policy in India is an elaborate one and there are a number of technical, analytical, institutional and dynamic inputs that go into the process.
- The stance on monetary policy and the rationale are communicated to the public mainly through the annual policy statement by the Governor of the RBI in April and the mid-term review in October. These statements are analytical, at times introspective and elaborate.

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- The interest rate regime is made more flexible and responsive to economic fundamentals. The interest rate policy is evolving and at the present stage of development, it may not be as effective as it could be in more deregulated environment mainly because the financial markets lack depth and far from being fully integrated.

10.6 KEY WORDS

- **Monetary policy:** It is used to denote the policy of the government regarding money matters.
- **Liquidity Adjustment Facility:** It is the mechanism by the RBI for managing the liquidity needs of the commercial banking system.
- **Market Stabilization scheme (MSS):** It is considered as a monetary policy introduced by the RBI to recover excess liquidity or money supply by selling government bonds.

10.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the concept of neutral money.
2. What is the importance of monetary policy in India?

Long-Answer Questions

1. 'Rising prices conflict with the principle of social justice.' Elucidate the statement.
2. Discuss the monetary policy making process in India.
3. 'The interest rate regime is made more flexible and responsive to economic fundamentals.' Do you agree with this statement? Give reasons for your answer.

10.8 FURTHER READINGS

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UNIT 11 FISCAL POLICY IN INDIA

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Structure

11.0 INTRODUCTION

Fiscal policy comprises taxation and expenditure decisions of the government. Fiscal policy is a vital component of the overall economic framework of the country and is hence, closely tied up with its general economic policy strategy. Fiscal policy comprises of tax policy, expenditure policy, and debt or surplus management. In this unit, you will study about the concept of fiscal policy. You will also get to study about the importance effects of fiscal policy of India.

11.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the concept of fiscal policy
- Analyse the importance and effects of fiscal policy of India

11.2 CONCEPT, IMPORTANCE AND EFFECTS OF FISCAL POLICY

Fiscal policy refers to the policy in connection with (a) government spending, (b) taxation, and (c) borrowing. The total volume of expenditure in the community can be increased by the right type of fiscal policy. Though, the fiscal techniques were discovered and first made use of during the depression of the 1930, the techniques are capable of being applied equally effectively in times of inflation.

Fiscal measures to achieve full employment or to avoid depression include (1) compensatory tax policy and (2) government expenditure policy.

1. The traditional view regards that taxation is for revenue only and the opposite view expressed by the Keynesian school is that taxation is for

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maintaining an adequate volume of public expenditure. All taxes bring about some reduction in the level of consumption or investment, and thus, affect the level of national income. Since, the level of employment depends on the level of total expenditure, it is always necessary to maintain that level of total expenditure which assures full employment. Experience has shown that, private consumption expenditure and private investment expenditure, if left uncontrolled, cannot be relied upon for maintaining a level of expenditure which is appropriate to a state of full employment. During depression, the policy should be to substitute public spending for deficient private spending and to reduce taxation to encourage private spending. During boom conditions, a maximum of taxation is necessary to defend the economy against price inflation. The general purpose of counter-cyclical taxation is to encourage private consumption and investment when national income is below the full employment level, and to break consumption and investment when full employment has been reached and further spending can result only in inflation.

2. It is held that the government should maintain a state of full employment by means of what is called compensatory spending. When prices go on falling and depression sets in, it is necessary for the government to go on injecting more and more money in order to offset the increasing disappearance of private funds from flow of spending. When prices go on rising and inflationary conditions appear, the government should reduce public expenditure to contain inflation. At this stage, the government should have surplus budgets in order to stave off inflation. The main purpose of compensatory spending is to fill up the gap between full employment expenditure and actual expenditure. If private consumption and investment expenditures are not appropriate for full employment, the government should spend huge sums of money to make good the deficiency in total spending.

Short-run and Long-run Fiscal Policy

Modern fiscal policy involves the process of shaping taxation and public expenditure in order to (1) reduce the fluctuations of trade cycle and (2) to contribute towards the maintenance of a growing, high-employment economy free from excessive inflation or deflation. When private investment and consumption spending create an inflationary (or deflationary) gap, it is the task of fiscal and monetary policy to offset the gap in the attempt to preserve price stability and full employment. The objective of fiscal policy is to achieve growth and full employment without inflation.

Fiscal weapons refer to taxation and expenditure policies. In this connection, modern economy is blessed with important ‘built-in stabilizers.’ Without any discretionary action, tax receipts change automatically when income changes, thereby reducing the size of the multiplier and serving to wipe out part of any

disturbance. Because the automatic stabilizers never fully offset instabilities of an economy, scope is left for discretionary programmes. The principal weapons of discretionary fiscal policy are (1) varying public works and other expenditure programmes, (2) varying transfer-expenditure programmes, and (3) varying tax rates cyclically.

Public works policy involves such time lags in getting under way as to make their use to combat short recession undesirable. Discretionary variations in transfer expenditures and in tax rates have greater short-run flexibility. When people dropped the notion that government budget had to be balanced every year, they thought that the budget would be balanced over the business cycle—with boom-time surpluses just matching the depression deficits. However, it is now realized that only by coincidence would the prosperity years just balance the recession years. If we are faced by secular stagnation with private saving and investment schedules tending much of the time to produce deflationary gaps, fiscal policy may succeed in maintaining stable high employment only by having a long-term increase in the public debt. If we are in for chronic exhilaration with demand so brisk as to lead much of the time to inflationary gaps, then active fiscal policy will have a bias towards surplus financing and a secular downward trend in the public debt. In connection with budget deficit or surplus, some new concepts are introduced. First, there is the important concept of 'fiscal drag or dividend.' Second, there is the concept of the 'full employment budgetary surplus' (or deficit) as contrasted with the actual surplus or deficit. Fiscal drag or dividend is the name for the automatic growth in tax revenues in an economy with a progressive tax structure and steady over-all growth. Unless needed to fight an inflationary gap, fiscal drag has to be offset by (1) government expenditure increase on public goods deemed vital, and (2) tax-rate cuts that increase people's disposable incomes and expenditures in the private sector.

Importance and Effects of Fiscal Policy

- The fiscal policy promotes the increase in the rate of capital formation for industries in private as well as public sectors.
- It helps the government to mobilise and use significant resources for critical projects through the amounts collected in taxation.
- It is considered as a tool for the government to help minimize the balance between wealth and income.
- It helps in encouraging rate of savings through various stimuluses.
- The fiscal policy helps companies in the private sector to increase its activities.

11.3 FISCAL SYSTEM: GOVERNMENT BUDGET AND TAXATION

In this section, let us study the government budget and taxation measures.

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Government Budget

A government budget is a legal document that is often passed by the legislature, and approved by the chief executive–or president. For example, only certain types of revenue may be imposed and collected. The two basic elements of any budget are the revenues and expenses. In the case of the government, revenues are derived primarily from taxes. Government expenses include spending on current goods and services, which economists call government consumption; government investment expenditures such as infrastructure investment or research expenditure; and transfer payments like unemployment or retirement benefits.

In India, the budget documents presented to Parliament include the Annual Financial Statement (AFS), Demands for Grants (DG), Appropriation Bill, Finance Bill and Fiscal Policy Strategy Statement for the financial year. In addition to these, individual Departments/Ministries also prepare and present to Parliament their Detailed Demands for Grants, Outcome Budget, and their Annual Reports. The Economic Survey which highlights the economic trends in the country and facilitates a better appreciation of the mobilization of resources and their allocation in the Budget is brought out by the Economic Division of Department of Economic Affairs, Ministry of Finance. The Economic Survey is presented to Parliament in advance of the Union Budget.

To monitor the performance management of various Ministries/Departments, Result Framework Document (RFD) system has been adopted by the Government. The RFD system is being implemented in the various Ministries/Departments in phased manner. Performance Management in the Government is a new concept which determines the performance index based upon the agreed objectives, policies, programs and projects/schemes. To ensure the success in achieving the agreed objectives and implementing agreed policies, programs and projects, the RFD also includes a commitment for required resources and necessary operational autonomy.

1. Annual Financial Statement (AFS)

Annual Financial Statement (AFS), the document as provided under Article 112, shows estimated receipts and expenditure of the Government of India for a year in relation to estimates and expenditures for the previous year. The receipts and disbursements are shown under the three parts, in which Government Accounts are kept viz., (i) consolidated fund, (ii) contingency fund and (iii) public account. Under the Constitution, Annual Financial Statement distinguishes expenditure on revenue account from other expenditure. Government Budget, therefore, comprises Revenue Budget and Capital Budget. The estimates of receipts and expenditure included in the Annual Financial Statement are for the expenditure net of refunds and recoveries, as will be reflected in the accounts.

(i) **Consolidated fund:** The existence of the Consolidated Fund of India (CFI) flows from Article 266 of the Constitution. All revenues received by

Government, loans raised by it, and also its receipts from recoveries of loans granted by it form the Consolidated Fund. All expenditure of Government is incurred from the Consolidated Fund of India and no amount can be drawn from the Consolidated Fund without authorization from Parliament.

(ii) Contingency fund: Article 267 of the Constitution authorizes the Contingency Fund of India which is an imprest (corpus) placed at the disposal of the President of India to facilitate Government to meet urgent unforeseen expenditure pending authorization from Parliament. Parliamentary approval for such unforeseen expenditure is obtained, post–facto, and an equivalent amount is drawn from the Consolidated Fund to recoup the Contingency Fund. The corpus of the Contingency Fund as authorized by Parliament presently stands at ₹ 500 crore.

(iii) Public account: Moneys held by Government in Trust as in the case of Provident Funds, Small Savings collections, income of Government set apart for expenditure on specific objects like road development, primary education, Reserve/Special Funds etc. are kept in the Public Account. Public Account funds do not belong to Government and have to be finally paid back to the persons and authorities who deposited them. Parliamentary authorization for such payments is, therefore, not required, except where amounts are withdrawn from the Consolidated Fund with the approval of Parliament and kept in the Public Account for expenditure on specific objects, in which case, the actual expenditure on the specific object is again submitted for vote of Parliament for withdrawal from the Public Account for incurring expenditure on the specific object.

(iv) Revenue budget: Revenue Budget consists of the revenue receipts of Government (tax revenues and other revenues) and the expenditure met from these revenues. Tax revenues comprise proceeds of taxes and other duties levied by the Union. The estimates of revenue receipts shown in the Annual Financial Statement take into account the effect of various taxation proposals made in the Finance Bill. Other receipts of Government mainly consist of interest and dividend on investments made by Government, fees, and other receipts for services rendered by Government. Revenue expenditure is for the normal running of Government departments and various services, interest payments on debt, subsidies, etc. Broadly, the expenditure which does not result in creation of assets for Government of India is treated as revenue expenditure. All grants given to State Governments/Union Territories and other parties are also treated as revenue expenditure even though some of the grants may be used for creation of assets.

(v) Capital budget: Capital Budget consists of capital receipts and capital payments. The capital receipts are loans raised by Government from public, called market loans, borrowings by Government from Reserve Bank and

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other parties through sale of Treasury Bills, loans received from foreign Governments and bodies, disinvestment receipts and recoveries of loans from State and Union Territory Governments and other parties. Capital payments consist of capital expenditure on acquisition of assets like land, buildings, machinery, equipment, as also investments in shares, etc., and loans and advances granted by Central Government to State and Union Territory Governments, Government companies, Corporations and other parties.

2. Demands for Grants

Article 113 of the Constitution mandates that the estimates of expenditure from the Consolidated Fund of India included in the Annual Financial Statement and required to be voted by the Lok Sabha are submitted in the form of Demands for Grants. The Demands for Grants are presented to the Lok Sabha along with the Annual Financial Statement. Generally, one Demand for Grant is presented in respect of each Ministry or Department. However, more than one Demand may be presented for a Ministry or Department depending on the nature of expenditure.

3. Appropriation Bill

Under Article 114(3) of the Constitution, no amount can be withdrawn from the Consolidated Fund without the enactment of such a law by Parliament. After the Demands for Grants are voted by the Lok Sabha, Parliament's approval to the withdrawal from the Consolidated Fund of the amounts so voted and of the amount required to meet the expenditure charged on the Consolidated Fund is sought through the Appropriation Bill.

4. Finance Bill

At the time of presentation of the Annual Financial Statement before Parliament, a Finance Bill is also presented in fulfillment of the requirement of Article 110 (1)(a) of the Constitution, detailing the imposition, abolition, remission, alteration or regulation of taxes proposed in the Budget. A Finance Bill is a Money Bill as defined in Article 110 of the Constitution. It is accompanied by a Memorandum explaining the provisions included in it.

5. Fiscal Policy Strategy Statement

The Fiscal Policy Strategy Statement, presented to Parliament under Section 3(4) of the Fiscal Responsibility and Budget Management Act, 2003, outlines the strategic priorities of Government in the fiscal area for the ensuing financial year relating to taxation, expenditure, lending and investments, administered pricing, borrowings and guarantees. The Statement explains how the current policies are in conformity with sound fiscal management principles and gives the rationale for any major deviation in key fiscal measures.

11.3.1 Fiscal Deficit and Inflation

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The difference between the government's total expenditure and its total receipts (excluding borrowing) is called fiscal deficit. The elements of the fiscal deficit are as follows:

- Revenue deficit, which is the difference between the government's current (or revenue) expenditure and total current receipts (i.e., excluding borrowing)
- Capital expenditure

The fiscal deficit is financed by borrowing from the RBI (which is also called deficit financing or money creation) and market borrowing (i.e., from the money market).

A fiscal deficit does not necessarily lead to inflation

Two arguments are usually given to connect a high fiscal deficit to inflation. The first argument is based on the fact that the portion of the fiscal deficit which is financed by borrowing from the RBI results in an increase in the money stock. Some believe that a higher money stock automatically brings inflation as 'more money chases the same goods'. However, this is an unsubstantiated argument. There are two flaws in this argument.

(i) It is not the 'same goods' which the new money stock chases as output of goods may raise due to the increased fiscal deficit. If any economy has unutilized resources, output is held in check by the lack of demand and a high fiscal deficit may be followed by greater demand and greater output.

(ii) The pace with which money 'chases' goods is not stable. It varies owing to changes in other economic variables. Thus, even if a part of the fiscal deficit translates into a larger money stock, it need not lead to inflation.

The second argument to associate fiscal deficits with inflation is that in an economy in which the output of some important goods cannot be increased, the increase in demand due to a larger fiscal deficit will raise prices. This argument is also criticized on the following grounds:

(i) This argument is evidently irrelevant for the economy with abundant supplies of foodgrains and foreign exchange.

(ii) Even if some particular goods are in short supply, rationing and similar strategies can halt any rise in price.

11.3.2 Taxation Measures

India has a well–developed tax structure with clearly demarcated authority between Central and State Governments and local bodies. Central Government levies taxes on income (except tax on agricultural income, which the State Governments can levy), customs duties, central excise and service tax. Value Added Tax (VAT), stamp duty, state excise, land revenue and profession tax are levied by the State

Governments. Local bodies are empowered to levy tax on properties, octroi and for utilities like water supply, drainage etc.

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Indian taxation system has undergone tremendous reforms during the last decade. The tax rates have been rationalized and tax laws have been simplified resulting in better compliance, ease of tax payment and better enforcement. The process of rationalization of tax administration is ongoing in India.

Direct taxes

In case of direct taxes (income tax, wealth tax, etc.), the burden directly falls on the taxpayer.

- **Income tax:** According to Income Tax Act 1961, every person, who is an assessee and whose total income exceeds the maximum exemption limit, shall be chargeable to the income tax at the rate or rates prescribed in the Finance Act. Such income tax shall be paid on the total income of the previous year in the relevant assessment year.
- **Corporate tax:** A company has been defined as a juristic person having an independent and separate legal entity from its shareholders. Income of the company is computed and assessed separately in the hands of the company. However the income of the company, which is distributed to its shareholders as dividend, is assessed in their individual hands. Such distribution of income is not treated as expenditure in the hands of company; the income so distributed is an appropriation of the profits of the company.
- **Capital gains tax:** A capital gain is income derived from the sale of an investment. A capital investment can be a home, a farm, a ranch, a family business, work of art etc. In most years slightly less than half of taxable capital gains are realized on the sale of corporate stock. The capital gain is the difference between the money received from selling the asset and the price paid for it. Capital gain also includes gain that arises on 'transfer' (includes sale, exchange) of a capital asset and is categorized into short–term gains and long-term gains.

Indirect taxes

Indirect taxes include excise duty and customs duty.

- **Excise duty:** Central Excise duty is an indirect tax levied on goods manufactured in India. Excisable goods have been defined as those, which have been specified in the Central Excise Tariff Act as being subjected to the duty of excise.
- **Customs duty:** Custom or import duties are levied by the Central Government of India on the goods imported into India. The rate at which customs duty is leviable on the goods depends on the classification of the goods determined under the Customs Tariff. The Customs Tariff is generally

aligned with the Harmonized System of Nomenclature (HSL). In line with aligning the customs duty and bringing it at par with the ASEAN level, government has reduced the peak customs duty from 12.5 per cent to 10 per cent for all goods other than agriculture products. However, the Central Government has the power to generally exempt goods of any specified description from the whole or any part of duties of customs leviable thereon. In addition, preferential/concessional rates of duty are also available under the various Trade Agreements.

- **Service tax:** Service tax was introduced in India way back in 1994 and started with mere 3 basic services viz. general insurance, stock broking and telephone. Today the counter services subject to tax have reached over 100. There has been a steady increase in the rate of service tax. From a mere 5 per cent, service tax is now levied on specified taxable services at the rate of 12 per cent of the gross value of taxable services. It is to be noted that all the above taxes have been subsumed within GST.

Goods and Services Tax (GST)

The idea of a Goods and Services Tax (GST) for India was first mooted sixteen years back, during the Prime Ministership of Shri Atal Bihari Vajpayee. In March 2011, Constitution (115th Amendment) Bill, 2011 was introduced in the Lok Sabha to enable levy of GST. However, due to lack of political consensus, the Bill lapsed after the dissolution of 15th Lok Sabha in August 2013. However, the Bill was again introduced in 2015 and was passed by the Lok Sabha and Rajya Sabha in 2016. The Constitutional amendment paved way for introduction of Goods and Services Tax in India. GST was launched with effect from 1st July 2017.

GST (Goods and Services Tax) is the biggest indirect tax reform of India. GST is a single tax on the supply of goods and services. It is a destination based tax. GST has subsumed taxes like Central Excise Law, Service Tax Law, VAT, Entry Tax, Octroi and so forth. GST is one of the biggest indirect tax reforms in the country. GST is expected to bring together state economies and improve overall economic growth of the nation.

GST is a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at the national level. It will replace all indirect taxes levied on goods and services by states and Centre. Businesses are required to obtain a GST Identification Number in every state they are registered.

Check Your Progress

4. What is capital budget?
5. Define fiscal deficit.

11.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. Fiscal policy refers to the policy in connection with (a) government spending, (b) taxation, and (c) borrowing.
2. Fiscal measures to achieve full employment or to avoid depression include (1) compensatory tax policy and (2) government expenditure policy.
3. The principal weapons of discretionary fiscal policy are (1) varying public works and other expenditure programmes, (2) varying transfer-expenditure programmes, and (3) varying tax rates cyclically.
4. Capital Budget consists of capital receipts and capital payments. The capital receipts are loans raised by Government from public, called market loans, borrowings by Government from Reserve Bank and other parties through sale of Treasury Bills, loans received from foreign Governments and bodies, disinvestment receipts and recoveries of loans from State and Union Territory Governments and other parties.
5. The fiscal deficit is financed by borrowing from the RBI (which is also called deficit financing or money creation) and market borrowing (i.e., from the money market).

11.5 SUMMARY

- Fiscal policy refers to the policy in connection with (a) government spending, (b) taxation, and (c) borrowing. The total volume of expenditure in the community can be increased by the right type of fiscal policy.
- Fiscal measures to achieve full employment or to avoid depression include (1) compensatory tax policy and (2) government expenditure policy.
- Modern fiscal policy involves the process of shaping taxation and public expenditure in order to (1) reduce the fluctuations of trade cycle and (2) to contribute towards the maintenance of a growing, high-employment economy free from excessive inflation or deflation.
- The principal weapons of discretionary fiscal policy are (1) varying public works and other expenditure programmes, (2) varying transfer-expenditure programmes, and (3) varying tax rates cyclically.
- A government budget is a legal document that is often passed by the legislature, and approved by the chief executive–or president.
- Annual Financial Statement (AFS), the document as provided under Article 112, shows estimated receipts and expenditure of the Government of India for a year in relation to estimates and expenditures for the previous year.

- Revenue Budget consists of the revenue receipts of Government (tax revenues and other revenues) and the expenditure met from these revenues. Tax revenues comprise proceeds of taxes and other duties levied by the Union.
- Article 113 of the Constitution mandates that the estimates of expenditure from the Consolidated Fund of India included in the Annual Financial Statement and required to be voted by the Lok Sabha are submitted in the form of Demands for Grants.
- The difference between the government's total expenditure and its total receipts (excluding borrowing) is called fiscal deficit.
- India has a well–developed tax structure with clearly demarcated authority between Central and State Governments and local bodies.
- GST (Goods and Services Tax) is the biggest indirect tax reform of India. GST is a single tax on the supply of goods and services. It is a destination based tax. GST has subsumed taxes like Central Excise Law, Service Tax Law, VAT, Entry Tax, Octroi and so forth. GST is one of the biggest indirect tax reforms in the country.

11.6 KEY WORDS

- **Fiscal drag:** It is a concept where inflation and earnings growth may push more taxpayers into higher tax brackets.
- **Government budget:** It is a legal document that is often passed by the legislature, and approved by the chief executive–or president.
- **Revenue budget:** It consists of revenue receipts of the government (revenues from tax and other sources), and its expenditure. Revenue receipts are divided into tax and non-tax revenue.

11.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What is short-term and long-term fiscal policy?
2. State the elements of the fiscal deficit.
3. Write a short note on the significance of GST introduced in India in 2017.

Long-Answer Questions

1. Analyse the importance of fiscal policy of India.

2. 'A fiscal deficit does not necessarily lead to inflation.' Do you agree with this statement? Give reasons for your answer.
3. Discuss the numerous reforms that been initiated in the Indian taxation system.

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11.8 FURTHER READINGS

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BLOCK-IV
INTERNATIONAL ECONOMIC AND ORGANISATIONS

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UNIT 12 INTERNATIONAL ECONOMIC CO-OPERATION

Structure

12.0 INTRODUCTION

Throughout the course of this book, you have learnt about the concepts of development, economic development, policy for development and the development of these policies at the national level. But the post-modern world that we are living in has made the world what many refer to as a global village. The root of this effort for global cooperation can be traced to the World War II, which saw a devastation of such magnitude that it not only resulted in loss of life and defeat of a particular ideology but also great destruction of economies world over. One of the positive lessons from the war was increased international cooperation, of which the prominent face is the United Nations. Countries have realised that to be successful in the ushering development at home, it is important to engage with other nations.

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International economic cooperation helps countries form groups to make policies which serve many nation's interest in tandem with the world. The areas of cooperation might be in terms of policy making, financial assistance, common markets, formation of negotiating fronts, transfer of knowledge and technology and much more. In this unit, you will learn about four important international economic associations: Organisation for Economic Co-operation and Development (OECD), South Asian Association of Regional Cooperation (SAARC), Eurasian Economic Union (EEU) and the forum of Brazil, Russia, India, China and South Africa (BRICS).

12.1 OBJECTIVES

After going through this unit, you will be able to:

- Recollect the origin of OECD
- Explain the organizational structure of the OECD
- Discuss the factors that led to the formation of SAARC and its objectives
- Describe the organizational structure and expansion of SAARC
- Explain the origins and organizational structure of EEU
- Discuss the origins and objectives of BRICS

12.2 OECD

The Organisation for Economic Co-operation and Development (OECD) is an international organization that works to build better policies for better lives. Their goal is to shape policies that foster prosperity, equality, opportunity and well-being for all. It draws on almost 60 years of experience and insights to better prepare the world of tomorrow. It currently has 37 countries from across the globe as member nations. Together with governments, policy makers and citizens, it works on establishing evidence-based international standards and finding solutions to a range of social, economic and environmental challenges. From improving economic performance and creating jobs to fostering strong education and fighting international tax evasion, it provides a unique forum and knowledge hub for data and analysis, exchange of experiences, best-practice sharing, and advice on public policies and international standard-setting.

12.2.1 Origin

In 1948 an Organisation for European Economic Cooperation (OEEC) was formed. This was to run the Marshall Plan financed by the US to help the war-torn European continent. Later on in 1960, the US and Canada joined the OEEC members to form and sign a convention for OECD. This was brought into force on 30 September 1961.

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Other countries joined in, starting with Japan in 1964. Today, 37 OECD member countries worldwide regularly turn to one another to identify problems, discuss and analyse them, and promote policies to solve them. The track record is striking. The US has seen its national wealth almost triple in the five decades since the OECD was created, calculated in terms of gross domestic product per head of population. Other OECD countries have seen similar, and in some cases even more spectacular, progress.

So, too, have countries that a few decades ago were still only minor players on the world stage. Brazil, India and the People's Republic of China have emerged as new economic giants. The three of them, with Indonesia and South Africa, are Key Partners of the Organisation and contribute to its work in a sustained and comprehensive manner. Together with them, the OECD brings around its table 39 countries that account for 80% of world trade and investment, giving it a pivotal role in addressing the challenges facing the world economy.

12.2.2 Organizational Structure

The OECD Council is the organization's overarching decision-making body. It is composed of ambassadors from member countries and the European Commission, and is chaired by the Secretary-General. It meets regularly to discuss key work of the organization, share concerns and take decisions by consensus. Once a year, the OECD Council meets for the Ministerial Council Meeting, which brings together heads of government, economy, trade and foreign ministers from member countries to monitor and set priorities for work, discuss the global economic and trade context, and delve further into issues such as the budget or the accession process.

Committees

The OECD works through more than 300 committees, expert and working groups which cover almost all areas of policy making. The committees propose solutions, assess data and policy successes, and review policy actions among member countries. They cover the same issue areas as government ministries, such as education, finance, trade, environment, development, and liaise with country-level experts. Committee participants come from member and partner countries, and represent state bodies, academia, business and civil society. Around 40,000 people take part in these meetings every year. Some discussions can evolve into negotiations in which all OECD countries define and follow common global rules.

Secretariat

The OECD Secretariat carries out the work of the OECD. It is led by the Secretary-General and composed of directorates and divisions that work with policy makers and shapers in each country, providing insights and expertise to help guide policy making based on evidence in close coordination with committees. Directorates report to the Secretary-General. 3300 employees of the Secretariat include

economists, lawyers, scientists, political analysts, sociologists, digital experts, statisticians and communication professionals, among others. The OECD also has centres in Berlin, Mexico, Tokyo and Washington D.C., which are part of the OECD's public affairs and communications team.

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Angel Gurría was appointed as the Secretary-General of the OECD on 1 June 2006. He is currently serving his third five-year mandate. Angel Gurría has firmly established the organization as a pillar of the global economic governance architecture including the G20, G7 and APEC, and a reference point in the design and implementation of better policies for better lives.

12.3 SAARC

The setting up of the South Asian Association of Regional Cooperation (SAARC) marked the beginning of regional cooperation in South Asia. It has been described as one of the most important developments of 1980s in this region. Its establishment is backed by the concept of regional integration, which has been defined by Earnest Hass as the 'process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities towards a new larger centre whose institutions possess or demand jurisdiction over pre-existing nation-states.' This is a process that links several nations of a region in collective decision-making system. Joseph Nye has said that the process of integration implies recognition of mutual obligations and common interests. Both, at the societal and political levels human relationships have generally been in conflict.

International relations are dominated by conflict which is a regular phenomenon. Conflicts tend to perpetuate. Even cooperation, the opposite of conflict, is often aimed at securing advantage in a situation of conflict. 'This phenomenon of conflict', says B.A. Prasad, 'had been vitiating all the endeavours for universal peace and harmony — manifesting itself either in the form of national animosities leading to war and destruction or intra-state violence ... fed on parochial tendencies.' The conflicts are largely responsible for halting the developmental processes, which in turn leads to impoverishment of the people. Therefore, the remedy for conflict lies in substituting it with cooperation. Regional organizations enable nation-states in a particular region to minimize their conflicts and promote cooperation. The process of regional integration is translated into institutional framework through the regional organizations.

Cooperation among states is promoted by common factors which may be geographic, ethnic, linguistic, religious, civilizational, politico-historical or socio-economic. The greater the interaction, the better are the chances of success of cooperative endeavours. The South-Asian region certainly has commonality of above-mentioned factors, with minor variations. Explaining the commonality of factors of regional cooperation in South Asia, B.A. Prasad wrote:

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> Geography had obviously intended the epical *Bharata Khanda* or the *Jambu Dweepa* to be one physical entity. Even in the ethno-linguistic and religio-civilizational terms the region has innumerable common strands causing the mosaic of a supra-nation, owing to inseparable admixtures. Their distinct origins or puritanical patents are neither distinguishable nor material. The entwining communication technology .... would suffice in times to come to psychologically further integrate the peoples of this region.

These factors have existed for a long time, but the concept of regional socio-economic and political cooperation is of recent origin. In South Asia, it was only in 1977 that the idea of a regional organization was first floated by the then Bangladesh President Zia-Ur-Rehman. Several regional organizations in different parts of the world had already come into existence and were working fairly satisfactorily. These included the Organisation of American States (OAS) set up in 1948, the Arab League established in 1945, the Association of South-East Asian Nations (ASEAN) set up in 1967, and the European Union (EU). The European Union in its present form was established in 1993. It evolved from the six-nation European Coal and Steel Community created in 1952. This 25-member union is the most perfect and effective of all regional organizations.

Article 52 of the Charter of United Nations provides for regional organizations. It permits 'the existence of regional arrangements or agencies for dealing with such matters relating to the maintenance of international peace and security as are appropriate for regional action...' provided they are consistent with the purposes and principles of the United Nations. Some of the regional organizations established after Second World War were of the nature of military alliance. These included North Atlantic Treaty Organisation (NATO) (1949), South East Asia Treaty Organisation (SEATO) (1954), the Inter-American Defence System (1948), the Australia-New Zealand-United States Pact (1952), CENTO (1959) and Warsaw Pact. All, but last, were controlled by the United States of America and, in the context of Cold War, were meant to protect member countries from communism. The Warsaw Pact, on the other hand, was to provide security to socialist states led by the USSR against the 'imperialist and capitalist' West. In addition to defensive organizations, number of functional organizations are also now in existence. These include European Union, ASEAN, APEC and SAARC.

12.3.1 Origin

The South Asian Association of Regional Cooperation (SAARC) was established in December 1985 at a summit of seven heads of states or governments, of South Asian countries, held at Dhaka. 'It was with the yearning to bring some measure of stability and peace, and to improve the subhuman conditions of eternal poverty and misery' of new born Bangladesh that President Zia-Ur-Rehman mooted the idea of regional cooperation in the immediate surroundings in 1977. It has been argued that compulsions of domestic conditions of economic chaos made Zia-Ur-Rehman suggest a regional organization for economic cooperation. According to Lt. Col. K.S. Ramanathan (Retd.), 'It was perhaps his logic that combination with

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other tiny nations and Pakistan forming ring on the top, and Sir Lanka at the bottom, will ensure a better bargaining strength and moral justification.' India and Pakistan, the two major actors of the region, were initially reluctant to join. Zia's proposal found ready acceptance by Sri Lanka, Nepal, Bhutan and Maldives. However, Pakistan felt that an association where India would play a major role was not in its interest. However, India and Pakistan overcome from their mutual issues, and soon decided to become the members of the SAARC.

India, Pakistan, Bangladesh, Nepal, Bhutan, Sri Lanka and Maldives were the seven original members of the SAARC. Gunnar Myrdal had said about South Asia in 1968, 'There is a similarity in the basic economic conditions of the South Asian countries. All are very poor, in general, the largest are the poorest ... All have endured a long period of stagnation ... and the levels of living of the masses are either lower or not substantially higher today than they were before the Second World War.' This unfortunate situation has largely remained unchanged, though with economic liberalization, since 1991 future appears to be brighter. In 1994, according to the Human Development Index, covering 173 countries, India ranked 135 and Pakistan 132 in terms of human development. In the Human Development Index released in 2019, India ranked 129th among 189 countries. There has been growing realization that cooperation at regional level can go a long way in areas such as poverty alleviation. Lack of cooperation can perpetuate economic misery in spite of liberalization.

Inspired by the then President Zia-Ur-Rehman, who had mooted the idea of SAARC while touring India, Pakistan, Nepal and Sri Lanka in 1977, the Government of Bangladesh circulated a working paper, titled 'Regional Cooperation in South Asia', advocating regional cooperation in economic, technical, scientific, social, cultural and educational fields. It was circulated in 1980 and it suggested that meetings at Foreign Secretary-level should examine prospects of regional cooperation. From 1977 to 1981 consultative and preparatory work had been done. The proposal was formally submitted to concerned governments in May 1980 by President Rehman. The first meeting of Foreign Secretaries was held at Colombo in April 1981. It was followed by six more such meetings in other capitals. Foreign Ministers of seven countries also held a number of meetings, before the Dhaka Summit.

An Integrated Programme of Action (IPA) was adopted in 1983 at Foreign Ministers meeting in New Delhi. The Programme was announced through the New Delhi Declaration. During negotiations, leading to Dhaka Summit (1985), it was agreed that SAARC would actively try for greater regional cooperation on the basis of sovereign equality of states, protection on the basis of territorial integrity, and non-interference in the internal affairs of each other. The cooperation was likely to grow in the economic, social and cultural spheres. Initially, eleven areas of regional cooperation were identified. They were: telecommunication, meteorology, transport, shipping, tourism, agricultural research, joint ventures, market promotion, scientific and technological cooperation, educational cooperation and cultural

cooperation. These areas were quite vast to promote cooperation and seek regional unity.

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The spade work for launching the SAARC was completed (after New Delhi meeting of Foreign Ministers in 1983) in the Foreign Ministers meetings held at Male in July 1984, and Thimpu in May 1985. It was decided to hold a summit of seven South Asian countries at Dhaka on December 7-8, 1985. The summit was presided over by Bangladesh President General H.M. Ershad. India was represented by the then Prime Minister Rajiv Gandhi. The other heads of states who attended Dhaka summit included President (Gen.) Zia-Ul-Haq of Pakistan, President J.R. Jayawardene of Sri Lanka, Kings of Nepal and Bhutan and President M. Abdul Gayoom of Maldives. The Dhaka Summit was held in a very cordial atmosphere. Sri Lanka's President Jayawardene praised the role of Late Mrs Indira Gandhi and Prime Minister Rajiv Gandhi in the establishment of SAARC and promotion of regional cooperation, despite tensions and bilateral disputes. Jayawardene went to the extent of suggesting that Rajiv Gandhi should be requested to lead the Association. A 10-point Charter of South Asian Association of Regional Cooperation (SAARC) was adopted, and SAARC was formally launched.

It was decided, and incorporated in the Charter, that bilateral issues or disputes shall not be raised or discussed in the SAARC forum. Secondly, it was agreed to establish a permanent Secretariat of the organization. Its details were to be worked out by the Foreign Ministers. The Secretariat was temporarily located in Dhaka and Mr Abdul Hasan was chosen as the SAARC Secretary-General. The Foreign Ministers later decided to establish the permanent Secretariat at Kathmandu (Nepal), where it now functions.

Objectives and Principles of SAARC

The Charter of the South Asian Association of Regional Cooperation (SAARC) has spelt out the following main objectives of the organization: (a) To promote the welfare of peoples in South Asian countries, and to improve their quality of life; (b) To accelerate economic growth, social progress and cultural development; (c) To promote and strengthen collective self-reliance; (d) To contribute to mutual trust, understanding and appreciation of one another's problems; (e) To promote mutual assistance in the economic, social, cultural, technical and scientific fields; (f) To strengthen cooperation with other developing countries; (g) To strengthen cooperation among themselves in international fora; and (h) To cooperate with other regional and international organizations.

The principles of SAARC, as defined in its Charter are: (i) Regional cooperation through SAARC shall be based on mutual respect for the principles of sovereign equality, territorial integrity, political independence, non-interference in internal affairs of other states and mutual benefit; (ii) Such cooperation shall not be a substitute for bilateral and multilateral cooperation, but shall complement them; and (iii) Such cooperation shall not be inconsistent with bilateral and multilateral obligations. Thus, the emphasis is on regional cooperation without

interference, either in bilateral or multilateral obligations, and without disregarding sovereign equality or challenging territorial integrity and independence of all its members.

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12.3.2 Organizational Structure

The organizational structure or institutional framework of SAARC is based on direct involvement of heads of states or governments, foreign ministers and foreign secretaries of all the member-nations. At the lowest level, there are a number of technical committees which are constituted for implementation of programmes and determining areas of cooperation along with all their financial and administrative implications. The technical committees are made up of officials and experts from various member-countries. They submit their reports to the Standing Committees. Next, there is a Standing Committee of Foreign Secretaries. It meets at least once a year; but may meet more frequently. The Standing Committee monitors coordination, mobilises resources and identifies new areas of cooperation of the Foreign Ministers and the summit. It reviews the work of all the technical committees, receives their reports and considers them. It issues guidelines for effective working of the technical committees.

Next, the Foreign Ministers constitute a Council of Ministers, or Foreign Minister's Conference. It generally meets twice a year, though at least one meeting a year is mandatory. It reviews the progress of regional cooperation and grants political approval to the recommendations of the Standing Committee.

The Foreign Ministers prepare agenda for the summit and finalise measures to be discussed and declarations to be adopted by heads of states or governments in their annual summit. Lastly, at the highest level are the annual summits of heads of states or governments. The summits are held in different countries, and they consider reports of the Foreign Ministers. The summits have political significance as they are the highest forum of South Asian regional cooperation. The financial resources are provided by member-countries.

After the end of the Cold War, the single most critical problem faced by the world is that of development and underdevelopment. Thus, East-West divide has been replaced by the divide between rich and developed North and the poor and developing South. South Asia is an important region of the developing South. As Prasad rightly concludes, 'In the wake of the Cold War conflictual dynamics the concept of regional cooperation is now flourishing.' Dealing the value of regional with cooperation in South Asia, Nancy Jetley says: 'The South Asian Association of Regional Cooperation (SAARC), marked the first regional effort to rise above residual prejudices and mistrust in order to evolve a positive framework of cooperative economic development to promote the welfare of the peoples of South Asia.' No other region in the world is more underdeveloped than, South Asia, and none has more poverty and exploding population. At the same time, no other region has comparable commonality in terms of geography, civilisation and ethno-linguistic affiliations. Yet, South Asia was the last of regional entities to have

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opted for regional economic cooperation. However, even this late effort seems to be floundering as it is difficult to ensure that Pakistan abides by the Charter of SAARC which prohibits discussion of bilateral issues in the SAARC, or as Professor Shanti Swarup says, to reconcile the often 'irreconcilable nationalistic egos' of India and Pakistan. Yet, there are lots of expectations and there is a hope that South Asian countries will overcome their prejudices and work together for prosperity of the region.

12.3.3 Expanding the SAARC

At the time of exploring the possibilities of a regional organization for South Asia in 1977, a suggestion was made to include, besides the seven who constitute SAARC, Iran, Afghanistan and Myanmar (Burma) as well. However, during eight years that were spent in planning and setting up the SAARC, the opinion centred around India, Pakistan, Nepal, Bhutan, Bangladesh, Sri Lanka and Maldives. After the formal establishment of SAARC in 1985, Afghanistan and Myanmar were sounded to join the Association. India was in favour of Afghanistan joining the SAARC, as it saw in this a support for the then (Pro-Soviet) Najibullah Government, and as a counter-balance to Pakistan's anti-India approach.

Pakistan was obviously unhappy about Najib's Afghanistan joining the SAARC. It said that criteria for admission of new members had not yet been worked out. The response from both the countries was not positive. Afghanistan at that time was under Soviet control and Myanmar had a government not favourably inclined to the democratic system of government.

In 1996, Mr I.K. Gujral, then India's External Affairs Minister in Deve Gowda Government, called for the expansion of SAARC by inviting Myanmar in the east and Afghanistan and Central Asian Republics in the West to join the organization. Gujral himself became the Prime Minister in 1997. It is not easy to expand the organization on such a large scale. Afghanistan in 1996 was too deeply involved in civil war, and to expect that country to respond to the call of SAARC would be unrealistic. Pakistan has been trying to sell the idea of Islamic Unity to the erstwhile Soviet Republics in Central Asia, and even to Iran. Thus, it may suit Pakistan's strategy to bring these countries in SAARC. Whether it would be in India's national interest, and whether regional cooperation would actually be promoted is doubtful. Professor S.D. Muni wrote:

> Strategically, it will free SAARC from its narrow sub-continental focus where South Asia's bilateral tensions, between India and Pakistan, are constraining regional cooperation. The larger size of tile regional community resulting from the inclusion of Central Asian countries may help Pakistan's often self-imposed ideological fixation against a South Asian regional identity. It is true that as a consequence of Central Asia's membership, a number of other volatile issues will be brought to South Asia's attention. This is because Central Asia is exposed to conflicting and powerful forces 'on account of its fragile state structure, rich oil and mineral reserves, burgeoning Islamic identity and strategic proximity to China and Russia.

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As for Myanmar, it was expecting an early membership of the Association of South-East Asian Nations (ASEAN). It did eventually join ASEAN. Once a democratic government was set up in Afghanistan, it became possible to invite it to join SAARC. Afghanistan did join SAARC in 2006, thus making it an eight-nation regional association.

Check Your Progress

1. What is the overarching decision-making body of the OECD?
2. Which Article of the Charter of United Nations provides for regional organizations?
3. When was the SAARC established?
4. Which nation's joining made SAARC an eight-nation regional association?

12.4 EEU

EEU stands for Eurasian Economic Union. It came into force on 1 January 2015. Total of five countries including in the alphabetical order Armenia, Belarus, Kazakhstan, the Kyrgyz Republic and the Russian Federation as the member nations.

12.4.1 Origin

The origin of EEU can be traced back to the creation of Eurasian Economic Community in the year 2000. It consisted of six states back then Belarus, Kazakhstan, Krygyztan, Russia and Tajikistan. Uzbekistan was a member for a brief period. Many years later in 2010, the three major member nations of Russian, Kazakhstan and Belarus pushed for and created a Eurasian Customs Union and in 2012 created the Eurasian Economic Space or a single economic space. Later on in May 2014, Belarus, Kazakhstan and Russia again signed a treaty for the creation of Eurasian Economic Union effectively meaning the termination of the Eurasian Economic Community. The treaty received approval from the parliaments of the states by October and came into effect from 1 January 2015. Armenia joined the EEU by signing the treaty in 2014 and joined effectively on 2 January 2015. And Kyrgystan underwent the similar process of signing the treaty in December 2014 and this became effective in August 2015. Negotiations with Tajikistan is still under process.

12.4.2 Organizational Structure

The structure of the EEU is similar to the European Union with respect to a single market and single bank, court and commission. While the commission is based out of Moscow, the court is located in Minsk and the bank in Almaty. Even though many are of the belief that the Russian President Vladimir Putin would have the EEU include political functions, the union is remains of economic nature. The major

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areas of focus include the free flow of goods and services, capital and workforce. The market is estimated to constitute of more than 170 million people and produces approximately $2.4 trillion of output.

The basic process of acceding to the Union is based on certain requirements of economic and political nature. All members of the Union must consent to the joining of a new nation state. This is subject to the new joining member's acceptance of the adherence to the existing EEU law and execution of previous decisions by the Eurasian Commission.

12.5 BRICS

BRICS is the acronym for the regional cooperation between the member nations of Brazil, Russia, India, China and South Africa. The term 'BRIC' (without South Africa) gained prominence in 2003 through its coining by Goldman Sach's economist Jim O'Neill. The analysts claimed that the four economies would be the most dominant in the world by 2050. These economies have become the fastest developing markets in the world in the recent years. They hold summits and act in cognizance of each other's interests. Many also refer to the BRICS as the foreign expansion opportunity given the member nations' low costs of labour and production.

12.5.1 Origin

It can be said that the initiation for BRICS, when it was BRIC was started by Russia. Prominent event was in September 2006, when at the Russian President's proposal, the first ever ministerial meeting of BRIC was held. This was at the sidelines of the UN General Assembly where the foreign ministers of Brazil, Russia and China and the defence minster of India met. The idea was to start a multilateral cooperation. The July of 2008, at the margins of G8 summit, the leaders of these nations met, making it an important step.

The first BRIC summit was hosted by Russia in June 2009. And it was here that the joint cooperation statement describing the goals of BRIC was issued:

> To promote dialogue and cooperation among our countries in an incremental, proactive, pragmatic, open and transparent way. The dialogue and cooperation of the BRIC countries is conducive not only to serving common interests of emerging market economies and developing countries, but also to building a harmonious world of lasting peace and common prosperity.

It was in 2010, that BRIC expanded with the addition of South Africa to become what it is known as today: BRICS.

Objectives

All the member nations of the BRICS are part of other international organizations including the UN security council, G20, Group-77, APEC, SAARC, MERCOSUR, African Union, among many others. Ever since the beginning of

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the BRICS formation, one of the main aims has been to promote fair governance in the international arena in alignment with the interests of the member nations. An example would be the reform brought in the IMF quota system which then included BRIC in the top ten largest shareholders.

Among the areas of cooperation in the member nations, there as diverse areas such as trade promotion, energy, education, science and technology, health, fight against crime innovation, etc. Today the international has been working in 30 different fields for the benefit of the population of these countries.

12.5.2 Structure

It is crucial to note here that BRICS is not an international organization, but a forum for annual summit for international cooperation between the five nations. These are presidential meetings. BRICS also organizes about 100 meetings annually which is inclusive of 15 ministerial meetings along with other important events. The Chairmanship is rotated annually between the nation in the order of the acronym BRICS.

Two new institutions were established as a part of BRICS at the 2014 Fortaleza Summit (Brazil). The first one is the New Development Bank (NDB) headquartered in Shanghai. It is a multilateral development bank which will extend financial support through varied instruments for public and private infrastructure and sustainable development projects in the member nations. The NDB has financed projects in the infrastructure and renewable energy sector worth more than 8-billion dollars. The second institution is the Contingent Reserve Arrangement (CRA) which was established to help the member nations by lending support in times of actual or potential short-term pressures of Balance of Payments.

Check Your Progress

5. State the major focus area of EEU.
6. When are the BRICS summit held?
7. Name the BRICS institution for lending support in times of BOP pressures.

12.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The OECD Council is the organization's overarching decision-making body. It is composed of ambassadors from member countries and the European Commission, and is chaired by the Secretary-General.
2. Article 52 of the Charter of United Nations provides for regional organizations.

3. The South Asian Association of Regional Cooperation (SAARC) was established in December 1985 at a summit of seven heads of states or governments, of South Asian countries, held at Dhaka.
4. Afghanistan's joining of SAARC in 2006, made it an eight-nation regional association.
5. The major areas of focus include the free flow of goods and services, capital and workforce.
6. BRICS summits are held annually for international cooperation between the five nations. These are presidential meetings.
7. The Contingent Reserve Arrangement (CRA) is the BRICS institution which was established to help the member nations by lending support in times of actual or potential short-term pressures of Balance of Payments.

12.7 SUMMARY

- The Organisation for Economic Co-operation and Development (OECD) is an international organization that works to build better policies for better lives. Their goal is to shape policies that foster prosperity, equality, opportunity and well-being for all.
- Once a year, the OECD Council meets for the Ministerial Council Meeting, which brings together heads of government, economy, trade and foreign ministers from member countries to monitor and set priorities for work, discuss the global economic and trade context, and delve further into issues such as the budget or the accession process.
- The setting up of the South Asian Association of Regional Cooperation (SAARC) marked the beginning of regional cooperation in South Asia.
- The concept of regional socio-economic and political cooperation is of recent origin. In South Asia, it was only in 1977 that the idea of a regional organization was first floated by the then Bangladesh President Zia-Ur-Rehman.
- An Integrated Programme of Action (IPA) was adopted in 1983 at Foreign Ministers meeting in New Delhi. The Programme was announced through the New Delhi Declaration.
- The spade work for launching the SAARC was completed (after New Delhi meeting of Foreign Ministers in 1983) in the Foreign Ministers meetings held at Male in July 1984, and Thimpu in May 1985. It was decided to hold a summit of seven South Asian countries at Dhaka on December 7-8, 1985.
- The organizational structure or institutional framework of SAARC is based on direct involvement of heads of states or governments, foreign ministers and foreign secretaries of all the member-nations. At the lowest level, there are a number of technical committees which are constituted for

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implementation of programmes and determining areas of cooperation along with all their financial and administrative implications.

- At the highest level are the annual summits of heads of states or governments. The summits are held in different countries, and they consider reports of the Foreign Ministers.
- EEU stands for Eurasian Economic Union. It came into force on 1 January 2015. Total of five countries including in the alphabetical order Armenia, Belarus, Kazakhstan, the Kyrgyz Republic and the Russian Federation as the member nations.
- The origin of EEU can be traced back to the creation of Eurasian Economic Community in the year 2000. It consisted of six states back then Belarus, Kazakhstan, Krygyztan, Russia and Tajikistan.
- The structure of the EEU is similar to the European Union with respect to a single market and single bank, court and commission.
- BRICS is the acronym for the regional cooperation between the member nations of Brazil, Russia, India, China and South Africa.
- It is crucial to note here that BRICS is not an international organization, but a forum for annual summit for international cooperation between the five nations. These are presidential meetings.
- The Chairmanship is rotated annually between the nation in the order of the acronym BRICS.
- Two new institutions were established as a part of BRICS at the 2014 Fortaleza Summit (Brazil): National Development Bank and Contingent Reserve Arrangement.

12.8 KEY WORDS

- **Regional integration:** As defined by Earnest Hass, it refers to the 'process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities towards a new larger centre whose institutions possess or demand jurisdiction over pre-existing nation-states.
- **Summit:** It refers to a meeting between the heads of government
- **Bilateral:** It means involving two parties or countries.
- **Treaty:** It refers to a formal written international agreement by actors in the international law.

12.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short Answer Questions

1. Briefly explain the origin of OECD.
2. Write a short note on the organizational structure of the OECD.
3. Mention some examples of regional alliances of military nature which came up after the World War II.
4. What are the main objectives mentioned in the Charter of SAARC? Also list its principles.
5. Write a short note on the origins and organizational structure of EEU.

Long Answer Questions

1. Discuss, in detail, the origin of SAARC.
2. Explain the organizational structure of the SAARC.
3. Describe the origin, objectives, and structure of BRICS.

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UNIT 13 INTERNATIONAL FINANCE INSTITUTIONS

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Structure

13.0 INTRODUCTION

We have learnt in the previous unit how international economic organizations help nations get to a common table to discuss their common interests and make policies to cooperate and facilitate economic development. An important part of this effort comes through the international financial organizations. As the name suggests, these international organizations have been established by different nations to solve the problems of finance and balance of payments troubles. Gaps in the financial pockets of the nations, hinder their growth prospects. So, the financial institutions help by lending assistance to the member organizations for developmental projects through varied instruments. In this unit, you will learn about the three major international financial organizations: World Bank, International Monetary Fund and the Asian Development Bank.

13.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the organization and functions of World Bank
- Discuss its lending activities and resources

- Recollect the objectives of IMF
- Describe its organization of IMF
- Examine the loan, financial instruments and other arrangements of IMF
- Discuss the objectives, origin and organization of ADB

13.2 WORLD BANK

World Bank, initially known as the IBRD is an offshoot of the Bretton Woods Conference of 1944. Its main function is to provide long-term capital assistance to its member countries for their reconstruction and development. In its initial days, the World Bank concentrated on reconstruction of the war-shattered European economies. Later, the Bank shifted its focus and 'development' of the backward countries began to receive prime importance. As an inter-governmental agency for lending for development, the Bank is mobilizing large-scale resources of private investors of the world's capital markets for investment in the developing countries.

The World Bank Group can be said to be a group of five institutions. For helping middle-income and creditworthy low-income country, the International Bank for Reconstruction and Development provides financial assistance. In 1956, the International Finance Corporation was founded for lending financial support to private companies and financial institutions from developing nations. With 1960, came the establishment of the International Development Association whose main focus was poorer countries. Later on, the International Centre for Settlement of Investment Disputes for arbitration over investment disputes and conciliation and the Multilateral Investment Guarantee Agency was established for credit enhancement and 'political risk insurance' in promoting FDIs in 'emerging economies.'

Since the credit rating of many developing countries is poor, they find it difficult to raise resources in international markets. The World Bank is, therefore, a vital source of finance for the developing countries. As of 2020, the Bank has provided $ 45.9 billion and has been supporting close to 12000 projects and has 189 countries as members. As of 2019, the Bank's paid-in and callable capital was $ 268.9 billion.

13.2.1 Organization and Function

Member countries are represented by the Board of Governors in the World Bank. They are the policy makers. It is seen that countries are usually represented by their finance or development ministers. They Board of Governors meet annually with the Board of Governors of the IMF.

Certain duties are given by the Board of Governors to 25 executive directors. While five largest shareholders are allowed to appoint an executive director, the rest are represented through elected executive directors. The executive directors

(Board of Directors) select a President for a renewable 5-year term. And he is responsible for the overall management of the bank.

Functions

The main functions of the Bank are:

- To aid in the reconstruction and the developing of territories of its member governments by facilitating investment of capital for productive purposes.
- To advertise private foreign investment by guaranteeing or by participating in loans and other investments of capital for productive purposes.
- Where private capital is not available on fair terms, to make loans for productive purposes out of its own resources or out of the funds borrowed by it,
- To promote the long-range growth of international trade and to uphold equilibrium in the balance of payments of the members. International investment should be promoted for the growth of the productive resources of members.

The bank as a principal object has adopted as its lending for productive projects which will lead to economic growth in its less developed member countries.

Lending activities

The World Bank can facilitate loans in the following ways:

- By way of participation in direct loans out of its own funds
- By way of participation in direct loans out of funds raised in the market of a member, or otherwise borrowed by the bank
- By guaranteeing in whole or part, loans made by private investors through the usual investment channel

The Bank may give loans directly to member countries or it may guarantee loans granted to member countries. The Bank normally makes loans for productive purposes like agriculture and surplus. The total amount of loans granted by the Bank should not exceed 100 per cent of its total subscribed capital and surplus. After calculation of the interest, an additional commission of 1 per cent for creating a special reserve against loss and 0.5 per cent for administrative expenses are charged.

Bank's lending policies

(a) All loans are for governments or they must be guaranteed by governments.

(b) Repayment period is within a period of ten to thirty-five years.

(c) Loans are only made in circumstances in which other sources are not readily available.

(d) Investigations are made regarding the probability of repayment, considering both the soundness of the project and the financial responsibility of the government.

(e) Sufficient surveillance is maintained by the Bank over the carrying out of the project to assure that it is relatively well executed and managed.

(f) Loans are sanctioned for economic and not on political considerations.

(g) The loan is meant to finance the foreign exchange requirements of specific projects; normally the borrowing country should mobilize its domestic resources. Two aspects of the lending activities of the Bank need to be highlighted.

First, since the Bank has to finance high-priority productive sectors of economies and determine 'creditworthiness' of the borrowers, it makes detailed studies through its Mission and Resident Representatives of the economy of the recipients of aid. The Bank's comprehensive and limited pre-investment surveys, which are financed either by the Bank or UNDP, have produced a situation where the headquarters of the Bank has become a 'monitoring' focus of the economies of the borrowing nations.

Resources

The resources of the Bank consist of capital and borrowings. Initially the authorized capital of the World Bank was $ 10,000 million, divided into 100,000 shares of $ 10,000 each. Of the share of capital,

(a) 2 per cent is payable by the member country in gold or US dollars. This portion is freely available for lending;

(b) 18 per cent is payable in a member's own currency. This portion is available for lending with the consent of the member whose currency is involved; and

(c) 80 per cent is kept in reserve to be paid by the member when called for.

Thus, only 20 per cent of each member's subscription is available to the Bank for lending activities. The balance 80 per cent serves as guarantee resources backing up the Bank's borrowing operations in international markets.

As per the Annual Report of 2019, World Bank's total commitments included commitments of $62,341 million. IDA made commitments to its members totalling $ 23,191 million.

Besides lending activities, the Bank renders a variety of technical assistance involving full-scale economic survey of the development potential of member countries or advice on particular projects. The interest rate charged is said to be high in comparison with the returns from the projects for which the loans are given. However, it cannot be denied that the Bank has been rendering useful service especially for the economic development of developing countries.

13.2.2 Mechanisms to Influence Trade

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One method that the World Bank uses to shape developing and developed country government's positions about trade and investment is through its role as a knowledge broker. The World Bank offers technical help to borrowing nations through loans and trainings. Many see the World Bank as a primary source of research and advice. The institution supplies data and analytical tools that are widely used by policy makers of developing nations in strategy development, trade and investment policy reforms and quantitative restrictions on exports. The allotment of IDA funding is based on Country Policy and Institutional Assessment (CPIA) ratings, CPIA ensures a biasness toward open markets and trade liberalization which lays the very foundation of the relationship of the borrowing country with the Bank.

Annually, all Fund members undergo 'Article IV' evaluation of their economies; the reports evaluate the extent to which the borrowing countries have met the trade reforms and the other macroeconomic measures required by the IMF, as conditions for its lending programmes.

Policy lending

Over 30 per cent of the World Bank loaning is in policy-based loans. Often they are referred to as structural adjustment or development lending. Loan disbursement is conditional upon a government's adoption or implementation of explicit reforms outlined in the credit documents and agreements. Trade-related reforms are frequently included amidst the aims of these loans. These prerequisites may also be outlined as 'prior actions', 'tranche release conditions' or 'triggers for future adjustment credits'.

Project lending

The World Bank's initial 'bread and butter' operations comprised of project loans, allowing resources for investment projects like highways, ports, health clinics, schools and oil and gas exploration. The Project loans contribute to about 70 per cent of World Bank lending. The establishment has recently intensified its emphasis on projects, specifically large infrastructure and agricultural projects aimed at expanding global trade.

Strategic direction of the World Bank Group

The 2007 annual meeting came at a crucial time for the Bank. The Bank had just rolled out the ideas for its strategical focus and negotiations on the fifteenth renewal of the International Development Association (IDA 15). The Bank is among the most effective international development players which portrays a central role in its efforts to assist the poorest nations to accomplish their goals. But it has been a while since a thorough assessment was done on the World Bank Group's strategy.

It is channelized towards giving its support in the fields highlighted by the Economist's report, including the best help to poor countries (especially Africa).

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It is more effective addressing the challenges facing post-conflict nations, maximizing support to the Global Public Goods agenda, particularly climate change, a differentiated business model for Middle Income Countries and strengthening the sharing of knowledge and learning.

Each of the regions poses its own challenges, as the Bank is (a) aspiring to promote sustainable economic growth, (b) strategizing how it can work better with the private sector to promote activity and investment in the poor nations, (c) how it can accommodate its involvement in fragile states, (d) how it can support less creditworthy countries at the same time, (e) what it can do to operate better with rising private and official donors, (f) how the opportunities may be afforded by its big capital reserves. These are some of the urging and immediate concerns for the Bank, according to the annual agenda that was announced. These are some of the pressing and immediate concerns for the Bank, according to the announced annual agenda.

Country-level effectiveness

The Bank has shown a substantial commitment to amending its operation and its impact on reduction of poverty. There are a number of areas where more needs to be done by the Bank. The most crucial issue is the need to place more Bank staff in the field. This is particularly true in the case of Africa and in both good performers and delicate states where the staff placed in the country interprets the context better and the political economy of the work that the Bank supports. They are also in a better position to join the policy dialogue with the government and other donors, support country ownership and develop a relationship with other donors. Decentralization needs to be coupled with increase in decision-making authority at the country level.

The Bank signed the Paris Declaration on Aid Effectiveness in 2005. One of the areas of the Paris Declaration, where the Bank has till date not performed well is in using country systems and avoiding the use of parallel project implementation units. The Bank needs to identify remedial actions.

To ensure more than efficient country-level working, the Bank has to constantly apply the 2005 Good Practice Principles on conditionality and make advancement on the areas highlighted in the 2006 progress report which include early revelation of its analytical work. Bank analysis is often of high quality, but late dissemination can sometimes hinder its impact. Poverty and Social Impact Analysis also needs to be increasingly used and encouraged.

Global public good: A framework for the role of the World Bank

The importance of global public good agenda for decrease of poverty is well-defined. A framework for the Bank's involvement in global public welfare is therefore to be welcomed and formed as an integral part of the long-term strategy of the Bank Group's.

There is a growing demand for the Bank to help nations incorporate national development priorities with regional and global priorities which include climate change, tackling communicable diseases, supporting trade and the sharing of knowledge. The Bank's challenge is not exclusively to address the global public good agenda, but also to be responsive to the needs and views of the developing nations and work towards a comprehensive and sustainable sight of globalization, based on a country-led approach.

They are required to bring better answers in the work with all its partners by using its knowledge and expertise to develop new and innovative policy solutions and financial mechanisms that will generate new resources to support global public good provision.

Check Your Progress

1. Name the conference one of whose offshoot is World Bank.
2. Who selects the President of the World Bank?
3. What is the use of CPIA?

13.3 IMF

The foundation of the post-World War II international monetary system was laid in a conference held at Bretton Woods, New Hampshire, in the United States. Representatives of fourty-five governments participated in the Bretton Woods Conference and agreed upon the Articles of Agreement of a new international organization in July 1944. The International Monetary Fund came into being in December 1945 after fourty-four countries signed the Articles of Agreement. The International Bank for Reconstruction and Development (The World Bank) was also formed as a part of the deliberations at Bretton Woods.

Over the years, the activities of the Fund have been considered as a provider of public goods to the world economy in the fields of surveillance of exchange markets, of a liberal trade and payments system and as a provider of finance and promoter of adjustment. Increasingly, the Fund is playing a major role in providing the international programme which is adopted by a member country. This gives confidence that the existing imbalances will be solved through the implementation of the appropriate policies. In doing so, the Fund provides the member country with invaluable assistance in securing additional external credit and when appropriate, the renegotiation of its external debt and avoidance of a net drain of resources, so as to facilitate an orderly adjustment process. Adoption of the Fund's programme restores a degree of confidence to the international financial community.

Although the Fund-supported programmes encompass a wide variety of policy measures and no two programmes are identical, they nevertheless exhibit certain similarities. The IMF adopts a monetary approach to the balance of

payments. The chief goals of IMF macroeconomic policies are rectification of the payments imbalance and reduction of inflation. Subsidiary goals include the promotion of growth and continued maintenance of debt service payments. Among the measures most commonly found in the IMF package are:

- Reduction of budget deficits by, for example, cutting government expenditure, reducing subsidies and raising taxes
- Devaluation of the national currency
- Reduction in government borrowing by placing limits on government borrowing from the central bank and ceilings on external borrowing
- Liberalization of foreign trade through the reduction of tariff and non-tariff barriers
- Demand management policies concentrating on reducing real wages, particularly in the public sector
- Price liberalization and deregulation
- Changes in interest rates so that they reflect the real interest rate

Stabilization policies aim to correct financial imbalance whether caused by domestic, economic mismanagement or external shocks. Payments imbalances can be classified into three types. The first are temporary deficits caused by the temporary loss of market or cyclical variations in the terms of trade; and in the second, temporary deficits are caused by excess demand, i.e. disequilibrium between aggregate demand and supply. A third form of imbalance arises from the fundamental disequilibria in the structure of the economy.

13.3.1 Objectives, Organization and Functions

In this section, let's have a look at the objectives, organizations and functions of the IMF.

Objectives of IMF

The primary objectives of IMF as incorporated in Article I are:

- Advancement of international monetary cooperation by providing the machinery for consultation and collaboration of international monetary problems with the help of a permanent institution.
- To promote exchange stability and orderly exchange arrangements and to avoid competitive devaluation.
- To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income.
- To help in the development of the productive resources of all members as primary objectives of economic policy.

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- To help re-establish the multilateral system of trade and payments and to eliminate foreign exchange restrictions.
- To give the members confidence by making the Fund's resources usable by them under adequate safeguards, hence leaving them with the opportunity to rectify maladjustments in their balance of payments without falling back on measures which are destructive of national or international prosperity.
- To provide for international adjustment, superior to deflation, by making available increased international reserves.
- To facilitate the expansion and balanced growth of international trade.

Organization of IMF

The IMF consists of the Board of Governors, the Executive Board and the Managing Director.

a) Board of Governors

The Board of Governors consists of one governor and one alternate governor for each member country. Each member country appoints its two governors. The Board normally meets once a year and is responsible for electing or appointing executive directors to the Executive Board. While the Board of Governors is officially responsible for approving quota increases, special drawing right allocations, the admittance of new members, compulsory withdrawal of members, and amendments to the Articles of Agreement and By-Laws, in practice it has delegated most of its powers to the IMF's Executive Board.

The Board of Governors is advised by the International Monetary and Financial Committee and the Development Committee. The International Monetary and Financial Committee has 24 members and monitors developments in global liquidity and the transfer of resources to developing countries. The Development Committee has 25 members and advises on critical development issues and on financial resources required to promote economic development in developing countries. They also advise on trade and global environmental issues.

b) Executive Board

24 Executive Directors make up Executive Board. The Executive Directors represent all 188 member-countries. Countries with large economies have their own Executive Director, but most countries are grouped in constituencies representing four or more countries.

Following the 2008 Amendment on Voice and Participation, eight countries each appoint an Executive Director: United States, Japan, Germany, France, the United Kingdom, China, the Russian Federation, and Saudi Arabia. The remaining 16 Directors represent constituencies consisting of 4 to 22 countries. The Executive Director representing the largest constituency of 22 countries accounts for 1.55 per cent of the vote.

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c) Managing Director

The IMF is led by a Managing Director, who is head of the staff and serves as Chairman of the Executive Board. The Managing Director is assisted by a First Deputy Managing Director and three other Deputy Managing Directors. Historically the IMF's managing director has been European and the president of the World Bank has been from the United States. However, this standard is increasingly being questioned and competition for these two posts may soon open up to include other qualified candidates from any part of the world. In 2011 the world's largest developing countries, the BRIC nations, issued a statement declaring that the tradition of appointing a European as managing director undermined the legitimacy of the IMF and called for the appointment to be merit-based. From 1 October 2019, Ms. Kristalina Georgieva, from Bulgaria, is Managing Director and Chairman of the Executive Board.

Basic Functions of IMF

The basic functions of IMF are:

- To lay down ground rules of international finance
- To provide short- and medium-term assistance for overcoming short-term balance of payments deficits
- To create and distribute reserves in the form of Special Drawing Rights (SDRs)

The Fund has 189 member countries accounting for about 80 per cent of the total world production and 90 per cent of the world trade.

Quotas are used to determine (a) the voting power of members, (b) their contribution to the Fund's resources, (c) their access to these resources, and (d) their share in the allocation of SDRs. The quota is assigned on the basis of the position of the member nation in the world economy.

SDRs refers to the Special Drawing Rights which is actually an international reserve asset. It is used for supplement the member nation's reserves. India's quota in the Fund is 13,114.4 million of SDRs. This is 2.76 of the total.

Main Features of the IMF System up to 1973

- ***Par Value System:*** The exchange value of a member's currency was fixed in terms of gold. Since the price of gold was officially fixed at US $35 per ounce, it also meant that par values were fixed in terms of the dollar. The dollar was used as the intervention currency as at that time it was as good as gold. In fact, members preferred to keep dollars in reserve, in as much as dollars earned interest while gold reserves did not.
- ***Change in Par Value:*** In order to achieve the short-term balance of payments equilibrium, members could borrow funds from IMF. If the IMF help did not serve the purpose, IMF could permit devaluation of the currency.

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If a member proposed a change of up to 10 per cent, no prior approval from IMF was required. If the proposed change was more than 10 per cent, it could be allowed provided (a) there was a fundamental disequilibrium, and (b) devaluation would be the right remedy for solving the fundamental disequilibrium. It is shown that severe depression abroad with prolonged unemployment at home and cases of structural disequilibrium could be taken as cases of fundamental disequilibrium.

- ***Exchange Control:*** It was not permitted on current transactions except
  (a) when a member's currency was under massive attack, and (b) when the Fund declared some currency as scarce. Members could use exchange control so far as the use of that currency was concerned.

Changes after 1973

- A member can peg its currency to (a) either a single major currency, (b) a basket of currencies, (c) allow it to float independently, or (d) adjust it to a set of indicators. Thus, there is a complete departure from the par value system. It is, however, subject to surveillance by the Fund.
- A reduction in the role of gold in the international monetary system. There is now no statutory place for gold. In fact, one-third of the gold stock with IMF was disposed of on concessional terms to fifty-nine eligible developing members. SDR is now the unit of account for the Fund's transactions.

13.3.2 IMF's Assistance to Members

Ordinarily, a Fund member subscribes its quota in the Fund by paying 25 per cent in reserve assets and 75 per cent in its own currency. When a member draws on the Fund's resources, it purchases the currencies of other member countries or SDRs with its own currency, leading to a rise in the Fund's holdings of the member's currency. The borrowing member must buy back its own currency within a specified period with SDRs or currencies specified by the Fund. The Fund's financial resources are made available to its members through a variety of policies, which differ mainly in the type of balance of payments need they address and in the degree of conditionality attached to them. The rules governing access to the Fund's general resources apply uniformly to all members.

For any purchase, a member is required to represent to the Fund, that the desired purchase is needed because of its balance of payments or reserve position or developments in its reserves. Access to the Fund's resources is determined in relation to a member's quota. The annual access limit is 100 per cent of the quota and the cumulative access limit is 300 per cent of the quota.

Loan instruments

Over the years, the IMF has developed a number of loan instruments that have been tailored to address specific circumstances of its membership. Low income nations are allowed to borrow at a concessional rate of interest through the Poverty

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Reduction and Growth Facility (PRGF). They can also get debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative. Non-concessional loans are provided through five main facilities: (a) Stand-by/Arrangements (SBA), (b) Extended Fund Facility (EFF), (c) Supplemental Reserve Facility (SRF), (d) Contingent Credit Lines (CCL), and (e) Compensatory Financing Facility (CFF).

All the other facilities are subject to the IMF's market-related interest rate, known as the rate of charge except for PRGF (which includes an adjustment for deferred charges and arrears). In some cases they carry an interest rate which is revised weekly to take account of the charges in the SDR interest rate, which is revised weekly to take account of charges in short-term interest rates in the major international money markets. The IMF discourages excessive use of its resources by imposing a surcharge on large loans, and countries are expected to repay loans early if their external position allows them to do so.

- **Heavily indebted poor countries initiative**

The Heavily Indebted Poor Countries initiative (HIPC) designed and rolled out in 1996 was designed to bring down the external debt burden of countries eligible to sustainable levels enabling them to service their external debts without the need of further debt relief and compromising growth. For the first time, a multilateral Paris Club, and other official and bilateral creditors got together to choose this kind of comprehensive approach toward debt relief. Assistance under the HIPC initiative is confined to countries that are eligible for PRGF and International Development Association (IDA) loans and have established firm track records of policy performance under PRGF and IDA supported programs but are not anticipated to achieve a sustainable debt situation after full use of conventional debt relief mechanisms.

- **Poverty reduction and growth facility**

For many years the IMF provided assistance to low-income nations through the Enhanced Structural Adjustment Facility (ESAF). In 1999, a conclusion was reached to beef up the focus on poverty, and the ESAF was substituted by PRGF. Loans under the PRGF are based on a Poverty Reduction Strategy Paper (PRSP), which is prepared by the country in cooperation with civil society and other development partners, in especially the World Bank. The interest rate levied on PRGF loans is 0.5 per cent and loans repaid over a period of 5 ½ –10 years.

- **Facility for low-income members**

Poverty reduction and Growth Facility (1999) provides long-term assistance for deep-seated, structural balance of payment difficulties; aims at sustained, poverty-reducing growth (replacing the Enhanced Structural Adjustment Facility created in 1987). Access norm and limits are: 140 per cent of the quota; under exceptional circumstances, it is 185 per cent of the quota. Maturities early repayment/obligatory repayment: No early repayment expectation /5½ –10 years.

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i. **Charges:** Concessional interest rate of ½ of 1 per cent a year; and it is not subject to surcharges.

ii. **Conditions:** Based on a Poverty Reduction Strategy, a paper (PRSP) is prepared by the country in a participatory process, integrating macro, structural and poverty-reduction policies.

iii. **Phasing and monitoring:** Semi-annual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews.

To conclude, it may be said that the use of the Fund's resources enables member countries to get the necessary foreign exchange resources in times of difficulties. The limits regarding the use of the IMF facilities may be exceeded in exceptional cases.

- **Extended fund facility**

Extended Fund Facility (EFF) was established in 1974 to help countries address more protracted balance of payments problems. The facility is available for longer periods (three years) and in large amounts than authorized under the tranche policies. It is especially designed to help countries suffering from serious payments imbalance due to structural maladjustments in production, trade and prices. The country should be prepared to implement a comprehensive set of corrective policies, covering a period of two or three years. Repayment is normally expected within 4 ½ – 7 years, unless an extension is approved.

- **Supplemental reserve facility**

The Supplemental Reserve Facility (SRF) was introduced in 1997 to meet the need for short-term financing on a large scale. The sudden loss of market confidence experienced by the emerging market economies in the 1990s led to massive outflows of capital, which required loans on a larger scale than anything the IMF had previously been asked to provide. Countries are expected to repay loans within 12–18 months and may request for an extension of up to one year.

- **Contingent credit lines**

The Contingent Credit Line (CCL) differs from other IMF facilities in that it aims to help members prevent crises. Established in 1999, it is designed for countries implementing sound economic policies, which may find themselves threatened by a crisis elsewhere in the world economy — a phenomenon known as 'financial contagion'. A CCL is subject to the same repayment conditions as SRF but carries a smaller surcharge of 1.5–3.5 percentage points.

- **Compensatory financing facility**

The Compensatory Financing Facility (CFF) was established in 1960 to assist countries experiencing either a sudden shortfall in export earnings or an increase in the cost of cereal imports, caused by fluctuating world commodity prices.

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Emergency assistance

The IMF provides emergency assistance to countries that have experienced a natural disaster or are emerging from a conflict. These loans are subject to the basic rate of charge and must be repaid within 3.25–5 years.

- **Natural disasters (1962):** Provides quick, medium-term assistance to members with balance of payment difficulties related to natural disasters.
- **Post conflict (1996):** Provides quick, medium-term assistance for balance of payment difficulties related to the aftermath of civil unrest or international armed conflict.
- **Access limits:** 25 per cent, though larger amounts can be made available in exceptional cases.
- **Maturity (early payment/obligatory repayment):** No early repayment is expected; repayment in 3.25–5 years.
- **Charges:** GRA rate of charge is not subject to surcharges and the possibility of interest subsidy, in case of financing, is available.
- **Conditions:** Reasonable efforts to overcome balance of payment difficulties, and focus on institutional and administrative capacity building to pave the way towards an upper credit tranche arrangement or an arrangement under the Poverty Reduction and Growth Facility .
- **Phasing and monitoring:** None

Exchange rate arrangement

The most important feature of the IMF system, as originally conceived, was the exchange rate arrangements of its member countries. The original plan of IMF tried to incorporate the feature of the gold exchange standard. The basic structure of exchange rates was that of fixed exchange rates, with flexibility built into it up to a certain extent. Under the gold exchange standard, one or two major countries remain on gold standard and their currencies are convertible into gold. Other countries make their currencies convertible into the currency which remains on the gold standard.

13.3.3 Special Drawing Rights

Special Drawing Rights (SDRs) is a potential claim on the freely usable currencies of IMF members. During the late 1960s, the growth in world resources did not keep pace with the growth in international trade. During 1963–68, the monetary reserves in the form of gold and US dollars increased by about 16 per cent, while in the same period the growth in the international trade was about 70 per cent. The slackness in the growth of resources was mainly due to dependence on the accretion of gold to monetary reserves. It was a foreboding that the slow growth of monetary reserve would hamper the growth of international trade and cause serious balance of payments difficulties to many countries.

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Nature of SDRs

SDRs are entitlements granted to member countries enabling them to draw from the IMF over and above their quotas. The arrangement is similar to a bank granting credit limit to its customer. When SDRs are allocated, a country's Special Drawing Account with the IMF is credited with the amount allotted. When the country experiences the need for foreign exchange it can sell SDRs to another country and get the foreign exchange. Thus, if India is in need of foreign exchange and the UK agrees to meet this need to the extent of SDR 100 million, the arrangement can be made as follows. India would inform IMF that it is selling SDR 100 million to the UK. As can be observed from the example, SDR is not a currency and has no backing of any security. Nor is the IMF liable on the SDRs allocated. It is merely an asset created out of book entries. It is an independent reserve asset supplementing other reserve assets, the volume of which could be increased or decreased according to the reserve needs of the international community. Every participating member in the SDR scheme is required to accept up to 200 per cent of its allocation of the SDRs when offered by other countries and exchange with currency of its own or other countries.

Allocation of SDRs

Allocation of SDRs is made to member countries in proportion to their quotas. The decision to allocate SDRs is taken periodically by the Board of Governors, taking into account the requirements of international liquidity.

Valuation and interest

SDR was introduced before the dollar crisis of August 1971. Keeping up with the monetary environment prevalent at the time of its introduction, initially the value of one SDR was equal to a specific quantity of gold (which was equal to the value of US$ 1) and was provided with an absolute gold value guarantee. That is why SDRs were popularly known as 'Paper Gold'. After the dollar debacle when the major currencies began to float, the SDR's link with gold had snapped. SDR was linked to a basket of sixteen principle currencies. In 1981, the composition of the basket was simplified by replacing sixteen currencies with those of the five major trading nations. The currencies and weightage given in the valuation revised with effect from 1 January 1991 are: US dollar (40 per cent), Deutsche mark (21 per cent), Japanese yen (17 per cent), French franc (11 per cent), and pound sterling (11 per cent). Since January 1999, the share of the Deutshe mark and French franc has been replaced by an equivalent euro. The SDR basket is now reviewed every five years or earlier to remain relevant to the dominant currencies in international trade. From 2016, this includes the following currencies with their respective weights: US dollar (41.73), Euro (30.93), Chinese Yuan (10.92), Japanese Yen (8.33) and Pound Sterling (8.09).

Utilization of SDRs

Originally, SDRs were to be used only for meeting balance of payments deficits. It could be used only in any of the three ways.

- **Transaction with designation:** When a country experiences a balance of payments deficit and requires other currencies, it has to apply to the IMF. The IMF designates another country with strong balance of payments and reserve position to accept SDRs from the deficit country and pay in exchange of some currency.
- **The sale of SDRs for currency by arrangement with another participant, i.e., without the designation by the IMF:** Such transactions by arrangement were permitted only if the user of SDRs was redeeming balances of his own currency held by another participant or if the Fund had authorized the particular transaction or had made general authorization of that particular type of transaction.
- **SDRs can be used in transaction with the Fund, for instance, in payment of charges to the Fund:** Now SDRs can be used directly among the members without the approval of IMF and without any restriction relating to the balance of payments requirements. SDR has gained importance both as a reserve asset and as a means of settlement of international transactions.

13.3.4 Towards Reforms of the IMF and Financial System

The extent of financial turmoil experienced during the 1990s and 2008-09 recession has demonstrated the limitations of both the national authorities and existing international financial system in anticipating, managing and containing them, and in securing an equitable distribution of the burden of adjustment. In view of the ramifications of financial crises, a debate has been initiated by multilateral institutions and the private sector, in both the developed and developing countries. The international financial architecture (IFA) requires correction of the deficiencies in the existing structure and incorporation of new institutional arrangements to handle financial crises more effectively in the future.

On the basis of the comprehensive review of the existing architecture, seven key elements of the emerging IFA can be identified. They are (i) an appropriate exchange rate regime, (ii) strengthening of domestic financial systems along the lines of international best practices and codes, (iii) establishment of safety nets including the adequacy of international reserves, (iv) management of capital flows and the approach to capital account liberalization, (v) transparency and dealing with information asymmetries, (vi) empowerment of existing international financial institutions and finally, (vii) arrangements for greater degree of participation of the private sector for new institutions.

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Existing International Arrangements

The discontent with the existing institutional framework of the international financial system stems from the perceived inadequacies in timing, size and content of the adaptation response of the international financial institutions, particularly the International Monetary Fund (IMF), to the recent global crises. There is a general agreement that IMF should continue to play an important role in providing international liquidity with (i) greater resource empowerment, (ii) enhancement of the early warning properties of multilateral surveillance through greater transparency, information dissemination and shorter reaction time, and (iii) greater accountability, participation and equity in the decision-making process in the IMF. Some of the contentious issues which have come up in the debates for reform of the present institutional apparatus for efficient functioning of the international financial system are (i) the lack of jurisdiction of IMF over financial flows and the inadequate emphasis on financial stability in Fund prescriptions, (ii) the absence of dynamism in the standard IMF programmes and conditionality to face the problems associated with the market failures, (iii) political economy in the voting process for authorizing IMF support to crisis-affected countries, (iv) the moral hazard of private sector bailouts in acting as lender-of-last-resort and (v) the unclear demarcation of roles between the Fund and the World Bank. In fact, the dissonant notes have been particularly sharp in the context of liquidity mismatches, disorderly debt workouts and market seizures which dominated the financial panics of the 1990s.

Capital flows to emerging market economies rose from 1.9 per cent of GDP in the 1980s to 3 per cent of GDP in the 1990s. Portfolio flows rose from 0.2 per cent of GDP over this period. The flows to ASEAN countries and Korea doubled. Efforts to manage policy conflicts posed by capital flow generally assumed a standardized approach across a wide range of countries. Sterilization through open market operations, reserve requirements, foreign currency swaps and stabilization bonds usually issued as short-term central bank instruments, foreign currency deposits with central banks, taxes, capital controls and easing restrictions on outflows have all been implemented with varying degrees of success and side-effects. In contrast, there has been a meagre increase in the Fund's resources, mainly due to the absence of a consensus on the means to augment these resources.

Despite these measures, host countries have experienced serious macroeconomic problems associated with capital inflows such as real appreciation of exchange rates, loss of autonomy in the conduct of monetary policy, volatile fluctuations in financial asset prices and impairment in the ability of financial institutions to intermediate in the face of asset price volatility. The high burden of social safety nets in these economies, which have simultaneously undertaken structural reforms, has led to deterioration in their fiscal positions. More fundamentally, rising capital flows exposed economies to large risk returns between exposures and increased the vulnerability to sudden reversals of capital flows and the contagion.

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The Funds' Role of Consultation

In all matters relating to the exchange rate changes, imposition of restrictions on current account and use of discriminatory practices, members are obliged to refer the Fund. Failing this, the members could be disqualified from having recourse to financial resources of the Fund. Such references may

- Take the form of supply of economic and financial data to the Fund by the member country.
- The staff of the Fund can call for various types of data from a member country as and when they require on an ad hoc basis.
- The staff teams visit member countries at least once a year for a first-hand study of economic and financial conditions in the member country. During the time of Annual General Meetings (AGM's) or at the time of negotiating credit arrangements, representatives of member countries arrange for consultations and discussions with the Board of Executive Directors. Informal consultations also take place between the member's Governor or Executive Director with the IMF staff, particularly at a time when the member country approaches the Fund for a standby arrangement or a credit drawl.

13.3.5 The Fund's Resources and Financial Facilities

The financial resources of the IMF are constituted from its members' quota subscriptions, which could be supplemented by borrowed resources. Allocation of SDRs is another means to meet the demand for international liquidity; so far, however, the cumulative allocation has counted to SDR 204.8 billion. Even though the IMF is authorized to borrow from private sources, so far it has borrowed only from national governments' central banks. The two borrowing agreements i.e., the General Arrangements to Borrow (GAB) and the New Arrangements (NAB) supplement the general resources. In response to the recent crisis in East Asia, the Fund has undertaken efforts to mobilize significant bilateral/multilateral resources to supplement its own resources.

The conventional approach has been to enlarge quotas with some emphasis on its redistribution in favour of developing countries. Notwithstanding these resource enhancements, there is a growing concern that quota reviews are regressive, as the evolution of India's quota in the Fund reflects. Revising the quota determination formula, delinking access to Fund resources and issue of SDRs by the Fund to itself, and subject to predetermined cumulative limits and other appropriate considerations are some of the proposals being mooted to enhance the Fund's role as an international lender of last resort.

Every member country is assigned a quota in the Fund. This assigned quota is determined by a formula which is the sum of the following four factors, increased by the percentage ratios of the average annual exports to national income of a member:

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(a) 2 per cent of the national income,
(b) 5 per cent of gold dollar balances;
(c) 10 per cent of average annual imports,
(d) 10 per cent of maximum variation in annual exports.

Each member's quota is thus fixed as their initial part of the Fund. Every member had to contribute its quota to the Fund in the form of

(a) Gold up to 25 per cent of its quota or
(b) 10 per cent of its net gold holdings or its equivalent in US dollars whichever is less, and the rest of the quota which is to be paid in the member's currency. The clause of 25 per cent of the quota in gold or US dollars was substituted by the contribution of SDR and convertible currencies in 1980. At the time, gold was valued at $ 35 per fine ounce and India paid $ 27.5 million in gold for a quota of $ 400 million. India's quota stood at SDR 3,056 million after the General Quota increase in 1990. And as mentioned earlier, as on 2020, India's quota stood at SDR 13,114.4 million.

The total of quotas of forty-four nations which gathered at Bretton Woods in 1944 was fixed at $ 8,800 million. By the end of December 1994, the membership rose to 178 with a total quota of SDRs 1, 44,620 million after the Ninth General Review of Quotas in 1990. And in 2020, with 189 members, the total quota is at SDR 475,723.7 million.

Other sources of funds

The amounts which Belgium, Canada, France, West Germany, Italy, Japan, Netherlands, Sweden, UK and USA took on to provide, was set in the agreement. Interest and service charges were owed on such loans in terms of agreed terms (up to five years) in gold, later substituted by SDR. The IMF borrowed not only from the above countries but as well as from others such as Saudi Arabia, on similar terms. The IMF can also take on any member's currency in exchange for the gold it holds.

Since August 1975, it was agreed by the members in the Interim Committee to reduce the role of gold to about one-sixth of its gold holdings was sold in auctions and in non-competitive bids and the proceeds realized amounted to US $ 5.7 billion of which $ 1.1 billion (comprising the capital value of the original gold) was added to the Fund's general resources and $ 4.6 billion representing profits, were added to the Trust Fund. About one-sixth of the gold of the Fund's holdings had been distributed to the members so far. The Fund still has two-thirds of the original quantity of gold.

Financial facilities

As a financial institution, the Fund provides temporary financial assistance for balance of payments purposes in the form of sale of currencies. When a member

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borrows from the Fund it purchases foreign currencies against its own currency. When repaying the loan, it repurchases its own currency against a foreign currency.

The Fund's exchange operations are classified into four categories as follows:

(i) The gold tranche is the amount of gold paid by a member to fulfill its quota, in addition to the credit position with the Fund (which is similar to the borrowings by other countries of its currency). If a country has 25 per cent of its quota in gold, then the member can draw upto this limit from the Fund automatically. If that country has also a credit position of 10 per cent of its quota as borrowings by other counties, then that country can is allowed to borrow up to 35 per cent of its assigned quota (gold tranche of 25 per cent plus super gold tranche of 10 per cent).

(ii) Four Credit Tranches**:** There are four credit tranches. Each credit tranche is equal to 25 per cent of its quota. If gold payment is 25 per cent of the quota and the remaining 75 per cent is paid in the country's own currency, the Fund can hold up to 200 per cent of a member's quota in its currency, and credit tranches would aggregate to 100 per cent of quota.

(iii) Compensatory financing facility was initiated in February 1963 to provide credit for any deficits in export whose proceeds were below a specified average annual figure. The member was allowed up to 50 per cent of the member's quota of credit which was raised in stages to 100 per cent of the quota in 1980.

(iv) The international buffer stock financing facility was constituted in June 1969 in regard to any chief commodity that the member country produces. The allowed credit limit is upto 50 per cent of its quota for special stocks of sugar, tin, cocoa, etc., under the various international commodity agreements.

The above facilities, except in the case of gold tranche which is automatic, are subject to the following conditions:

(i) No member should draw in any twelve-month period more than 25 per cent of its quota.

(ii) No member should draw in the total beyond a point where the Fund's holdings of the member's currency reaches 200 per cent of its quota, which it will have if it has borrowed up to 25 per cent and its own currency up to 75 per cent.

(iii) The combined draw under compensatory financing and buffer stock financing should not exceed 75 per cent of the member's quota.

(iv) The total holding by IMF of any member's currency under all the above facilities should not exceed 275 per cent of the quota of that member, and this condition has been waived many times.

The conditionality of drawings under the different credit tranches and other financial facilities change according to the state of the country and the economic

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and financial policies pursued. Requests for any drawings beyond the first credit tranche require considerable justification and the conditions put down would be more stringent in terms of policies. This will be pursued by the member country in fiscal, monetary or any foreign exchange fields to provide a quick restorative programme of action for remedying the balance of payments disequilibrium. These conditions are imposed with a fair degree of flexibility.

Check Your Progress

4. Mention the countries which appoint an executive director for the IMF.
5. List the basic functions of the IMF.
6. What is the use of quotas in the IMF?
7. What was the EEF specially designed for?

13.4 ADB

The Asian Development Bank (ADB) envisions a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty in the region. ADB assists its members, and partners, by providing loans, technical assistance, grants, and equity investments to promote social and economic development.

ADB maximizes the development impact of its assistance by facilitating policy dialogues, providing advisory services, and mobilizing financial resources through co-financing operations that tap official, commercial, and export credit sources. services, and knowledge upport.

13.4.1 Origin

The ADB was conceived in the 1960s as a financial institution which had would have its root in Asia for Asian nations. The first resolution for its initiation was passed in 1963 at the Ministerial Conference on Asian Economic Cooperation held by the United Nations Economic Commission for Asia and the Far East. Philippines was the first country was chosen to host the new institution in 1966. From 31 members at its establishment in 1966, ADB has grown to encompass 68 members—of which 49 are from within Asia and the Pacific and 19 outside. The focus in the 60s was on assistance for food production and rural development.

In 1974, Asian Development Fund was established to provide low-interest loans to ADB's poorest members. In the 1980s, the ADB started working with several non-governmental organizations too. In the 1990s, ADB became the first multilateral organization to have a Board-approved governance policy to ensure that development assistance fully benefits the poor. It was also the time of Asia's worst financial crises. In 1999—recognizing that economic development was bypassing many people in the region—ADB adopted poverty reduction as its overarching goal. Throughout the first decade of 2000s, the ADB supported

countries through SARS epidemic, natural disasters as well as the economic crises of global recession.

In May 2014, plans were announced to combine the lending operations of ADB's two main funds, the Asian Development Fund and its ordinary capital resources. The merger was done to boost ADB's total annual lending and grant approvals to as high as $20 billion—50% more than the previous levels.

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13.4.2 Organization

The ADB has 68 shareholding members which includes 49 from the Asia and Pacific region. Its highest policy making body is the Board of Governors. This has representatives from each of the member nations. The Board of Directors is made up of 12 members elected by the governors for working full-time at the ADB. 8 of these are from the Asia and Pacific region and 4 from outside the region. The Chairperson of the Board of Directors is the President of the ADB. It is the director's job to supervise financial statements, approve its administrative budget, and review and approve all policy documents and all loan, equity, and technical assistance operations. The management apart from the president also has 6 vice-presidents. It is responsible for supervising the operational, administrative and knowledge departments of the ADB.

Financing Products and Services

ADB raises funds through bond issues on the world's capital markets. It also relies on members' contributions, retained earnings from lending operations, and the repayment of loans. It also provides loans and grants from a number of special funds.

Its products and services are divided into the following categories:

- Public Sector financing
- Private Sector Financing
- Cofinancing Partnerships
- Results-Based Lending Programs
- Funds and Resources

Check Your Progress

8. How many members does the ADB have?
9. Mention the sources of ADB's funds.

13.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. World Bank, initially known as the IBRD is an offshoot of the Bretton Woods Conference of 1944.

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2. The executive directors (Board of Directors) select a President for a renewable 5-year term. And he is responsible for the overall management of the bank.
3. The allotment of IDA funding is based on Country Policy and Institutional Assessment (CPIA) ratings, CPIA ensures a biasness toward open markets and trade liberalization which lays the very foundation of the relationship of the borrowing country with the Bank.
4. The following eight countries each appoint an Executive Director for the IMF: the United States, Japan, Germany, France, the United Kingdom, China, the Russian Federation, and Saudi Arabia.
5. The basic functions of IMF are:
   - To lay down ground rules of international finance
   - To provide short- and medium-term assistance for overcoming short-term balance of payments deficits
   - To create and distribute reserves in the form of Special Drawing Rights (SDRs)
6. Quotas are used to determine (a) the voting power of members, (b) their contribution to the Fund's resources, (c) their access to these resources, and (d) their share in the allocation of SDRs.
7. The Extended Fund Facility (EFF) especially designed to help countries suffering from serious payments imbalance due to structural maladjustments in production, trade and prices.
8. The ADB has 68 shareholding members which includes 49 from the Asia and Pacific region.
9. ADB raises funds through bond issues on the world's capital markets. It also relies on members' contributions, retained earnings from lending operations, and the repayment of loans. It also provides loans and grants from a number of special funds.

13.6 SUMMARY

- World Bank, initially known as the IBRD is an offshoot of the Bretton Woods Conference of 1944. Its main function is to provide long-term capital assistance to its member countries for their reconstruction and development.
- The World Bank Group can be said to be a group of five institutions including the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the International Centre for Settlement of Investment Disputes and the Multilateral Investment Guarantee Agency.
- The bank as a principal object has adopted as its lending for productive projects which will lead to economic growth in its less developed member countries.

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- The Bank may give loans directly to member countries or it may guarantee loans granted to member countries. The Bank normally makes loans for productive purposes like agriculture and surplus. The total amount of loans granted by the Bank should not exceed 100 per cent of its total subscribed capital and surplus.
- The World Bank offers technical help to borrowing nations through loans and trainings. Many see the World Bank as a primary source of research and advice.
- There is a growing demand for the Bank to help nations incorporate national development priorities with regional and global priorities which include climate change, tackling communicable diseases, supporting trade and the sharing of knowledge. The Bank's challenge is not exclusively to address the global public good agenda, but also to be responsive to the needs and views of the developing nations and work towards a comprehensive and sustainable sight of globalization, based on a country-led approach.
- Representatives of forty-five governments participated in the Bretton Woods Conference and agreed upon the Articles of Agreement of a new international organization in July 1944. The International Monetary Fund came into being in December 1945 after forty-four countries signed the Articles of Agreement.
- The chief goals of IMF macroeconomic policies are rectification of the payments imbalance and reduction of inflation. Subsidiary goals include the promotion of growth and continued maintenance of debt service payments.
- The IMF consists of the Board of Governors, the Executive Board and the Managing Director.
- Over the years, the IMF has developed a number of loan instruments that have been tailored to address specific circumstances of its membership. Low income nations are allowed to borrow at a concessional rate of interest through the Poverty Reduction and Growth Facility (PRGF). They can also get debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative.
- Non-concessional loans are provided through five main facilities: (a) Stand-by/Arrangements (SBA), (b) Extended Fund Facility (EFF), (c) Supplemental Reserve Facility (SRF), (d) Contingent Credit Lines (CCL), and (e) Compensatory Financing Facility (CFF).
- SDRs are entitlements granted to member countries enabling them to draw from the IMF over and above their quotas. The arrangement is similar to a bank granting credit limit to its customer. When SDRs are allocated, a country's Special Drawing Account with the IMF is credited with the amount allotted.
- The discontent with the existing institutional framework of the international financial system stems from the perceived inadequacies in timing, size and content of the adaptation response of the international financial institutions,

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particularly the International Monetary Fund (IMF), to the recent global crises.

- In all matters relating to the exchange rate changes, imposition of restrictions on current account and use of discriminatory practices, members are obliged to refer the Fund. Failing this, the members could be disqualified from having recourse to financial resources of the Fund.
- The financial resources of the IMF are constituted from its members' quota subscriptions, which could be supplemented by borrowed resources. Allocation of SDRs is another means to meet the demand for international liquidity. Even though the IMF is authorized to borrow from private sources, so far it has borrowed only from national governments' central banks.
- As a financial institution, the Fund provides temporary financial assistance for balance of payments purposes in the form of sale of currencies. When a member borrows from the Fund it purchases foreign currencies against its own currency. When repaying the loan, it repurchases its own currency against a foreign currency.
- Asian Development Bank (ADB) assists its members, and partners, by providing loans, technical assistance, grants, and equity investments to promote social and economic development.
- From 31 members at its establishment in 1966, ADB has grown to encompass 68 members—of which 49 are from within Asia and the Pacific and 19 outside.
- The ADB's highest policy making body is the Board of Governors. This has representatives from each of the member nations.
- ADB raises funds through bond issues on the world's capital markets. It also relies on members' contributions, retained earnings from lending operations, and the repayment of loans. It also provides loans and grants from a number of special funds.

13.7 KEY WORDS

- **Bretton Woods Conference:** It refers to the gather of delegates from 44 countries in Bretton Woods, New Hampshire, in July 1944 for agreements on new rules in the international monetary system post World War II.
- **Structural adjustment or development lending:** It refers to the set of economic reforms which must be made by a country in order to secure a load by the IMF or World Bank
- **SDRs** are entitlements granted to member countries enabling them to draw from the IMF over and above their quotas.
- **Credit Tranches:** It refers to system of phases in which IMF releases loan funds to the member countries.

13.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short Answer Questions

1. Write a short note on the main institutions of the World Bank Group.
2. What are the main functions of the World Bank?
3. List the ways in which loans are facilitated by the World Bank.
4. What are the measures most commonly found in the IMF packages?
5. List the primary objectives of IMF.
6. Briefly explain the categories of the Fund's exchange operations.

Long Answer Questions

1. Discuss the resources of the World Bank and the mechanisms it uses to influence trade.
2. Assess the main features of IMF pre and post 1973.
3. Describe the organizational structure of the IMF.
4. Examine the instruments through which IMF lends its support to the member nations.
5. Explain the nature, allocation, valuation and utilization of SDRs.
6. Examine the sources of IMF's fund.
7. Discuss the origin, organizational structure and financing methods used by the ADB.

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UNIT 14 INTERNATIONAL TRADE ORGANIZATIONS

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Structure

14.0 INTRODUCTION

Up till now you have learnt about the international economic and financial organizations. In this unit, you will learn about the important international trade organizations including the UNCTAD, the WTO/GATT and the OPEC. Like financial organizations help in providing financial assistance and knowledge to the member nations. The international trade organizations are usually established with the aim to facilitate smooth trade between the member nations. These agreements are on the terms of trade. This includes specifications on tariffs, subsidies, technical requirements, category of goods, prices charged, access to market, fair competition rules among other important factors.

14.1 OBJECTIVES

After going through this unit, you will be able to:

- Recollect the primary objective and organization of UNCTAD
- Describe its important achievements
- Discuss the origin and principles of WTO/GATT
- Assess the areas of operation of WTO
- Describe the origin of OPEC
- Explain the organization structure of OPEC

14.2 UNCATD

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The United Nations Conference on Trade and Development (UNCTAD) was established in 1964 in order to provide a forum where the developing countries could discuss the problems related to their economic development. This was set up essentially because of the peculiar problems of the developing countries. With 195 members, UNCTAD is presently the only body where developed as well as centrally planned countries are members. It was established as an intergovernmental body under the United Nations.

The primary objective of UNCTAD is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology. The conference meets once in four years. The first conference took place in Geneva in 1964.

Generalized System of Preferences

One of the principal achievements of UNCTAD has been to conceive and implement the Generalized System of Preferences (GSP). It was argued in UNCTAD that in order to promote exports of manufacturers from the developing countries, it would be necessary to offer special tariff concessions to such exports. Accepting this argument, the developed countries formulated the GSP Scheme under which exports of manufactures, semi-manufactures and certain agricultural items from the developing countries enter the developed countries either free of duty or at reduced rates. Currently, 13 GSP schemes are in operation. The following countries grant GSP preferences: Australia, Belarus, Canada, the European Union, Iceland, Japan, Kazakhstan, New Zealand, Norway, the Russian Federation, Switzerland, Turkey and the United States of America.

Common Fund

Another major achievement of UNCTAD has been the formulation of an integrated programme on commodities. As it is well known, the prices of primary products undergo high levels of fluctuation in the international market. To stabilize these prices, UNCTAD has suggested the creation of a common fund which will stabilize the prices of primary products through buffer-stocks. The common fund was ratified and came into effect in June 1991. The common fund as it stands now has two windows. The first window finances the buffer stock operations of certain primary products, while the second window finances the promotional activities relating to product development and marketing. The initial capital of the first window is $400 million while that of the second window is $350 million.

Characteristics of the common fund

(i) This is the first institution which had been formed by all the members of the United Nations, the including East European countries and China.

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(ii) This is the only organization where the developing countries have a major say in the decision-making system. The developing countries as a group account for 47 per cent of the total votes whereas the percentages for the developed countries and the East European counties are 42 and 8, respectively.

Debt Management and Financial Analysis System (DMFAS) Programme

UNCTAD is also endeavouring to reduce the debt burden of the developing countries, as these countries have taken large amounts of loans from bilateral and multilateral sources. Since 1983, UNCTAD has been providing technical assistance in debt management through the Debt Management and Financial Analysis System (DMFAS) Programme. It endorsed its commitment to a multilateral trading system that is fair, equitable and rule based, operates in a non-discriminatory and transparent manner and provides benefits to all countries.

Organization Structure

The UNCTAD works in five division, headed by the Secretary General:

- Division for Africa, least developed countries and special programmes
- Division on globalization and development strategies
- Division on investment and enterprise
- Division on international trade and commodities
- Division on technology and logistics

Check Your Progress

1. In how many years does the UNCTAD conference meets?
2. What are the two windows of the common fund?

14.3 WTO/GATT

The World Trade Organization (WTO) provides the basic framework for conduct of international trade and sets up the norms for the conduct of such trade. International trade is the product of the twentieth century. Principles of international trade are as much relevant now as in the earlier times. It is the conduct of international trade that WTO lays the framework and the norms for its conduct.

14.3.1 Origin

The period between First and Second World Wars was characterised by near-open economic warfare between nations. They extensively resorted to expedient measures meant for short-term gains at the cost of each other. Realising the long-term futility of such economic conflicts and their resultant collective loss for the world economy as a whole, leading countries of the world became desirous of

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preventing the recurrence of such a chaotic situation. They wanted that the post-War II world economic order should have a rule-based and orderly trade regime and it should be supported by:

- a reconstruction of war-torn economies,
- a solution of the developmental problems, and
- a healthy international financial system capable of tackling exchange rate and balance of payments problems.

Accordingly, they planned to create the following three international institutions for the attainment of these objectives.

As you have learnt in Unit 13, the first institution, namely, the International Bank for Reconstruction and Development (later known as the World Bank) was created for financing (i) reconstruction of the war-devastated economies (particularly of Western Europe), and (ii) economic development of the backward countries. The second institution, the International Monetary Fund, was created for supporting a regime of stable exchange rates and for overcoming short term balance of payments difficulties faced by member countries; The third institution (which they failed to create) was the International Trade Organization (ITO). Its objective was to create a new world economic order incorporating a system of free trade with minimum or zero tariffs and zero non-tariff barriers.

Proposal for International Trade Organization: The Havana Charter

On 16 February 1946, the UN Economic and Social Council authorized an International Conference on Trade and Employment. The Conference was at Havana from 21 November, 1947 to 24 March 1948. The final version of the proposals for instituting an International Trade Organization (ITO) was signed by 53 countries. This document is known as the Havana Charter. The Havana Charter contained the following important proposals:

- Reduction in international trade barriers;
- Promotion of economic development;
- Promotion of full employment;
- Prevention of restrictive business policies; and
- Stabilization of prices of the international commodities.

GATT comes into existence

The Havana Charter was not ratified by US Senate and other governments because some of its provisions were not acceptable to them. However, the General Agreements on Tariffs and Trade (GATT) Secretariat had already been set up as an interim arrangement. Accordingly, to salvage whatever was possible of the Havana Charter, another independent treaty was signed at Geneva by leaving out some of the provisions of the Havana Charter. This treaty brought into existence the General Agreement on Tariffs and Trade (GATT) in 1948. The signatories of GATT were known as the Contracting Parties.

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Experience of Inter-War chaotic practices prompted leading economic powers of the world to search for a rule-based and orderly world trade regime. However, they failed to create an all-encompassing institution on the lines of the World Bank and the IMF. What came into existence was a less ambitious GATT, with broadly the same objectives but less binding obligations.

Basic principles of GATT

GATT was based upon the principles of non-discrimination, consultation, elimination of non-tariff barriers, and elimination of export subsidies. Its principles may be discussed under the following heads:

- **Non-discrimination:** It means unconditional acceptance of the "most-favoured nation" (MNF) principle with some exceptions associated with (a) economic integration, such as customs unions, and (b) trade between a nation and its former colonies and dominions. The principle of MNF means that if a country extends better trade treatment to one country, it extends it indiscriminately to all Contracting Parties of GATT. In that sense, this clause rules out any preferential treatment among nations as far as trade policy is concerned. However, in actual implementation, there have been several instances of violation of this principle. This was particularly because formation of customs unions was allowed also under GATT, and a customs union discriminates in favour of member countries and against non-members.
- **Elimination of non-tariff barriers to trade:** GATT aimed at removal of all non-tariff barriers to trade except for tiding over balance of payments or some other problems. Thus, for example, GATT allowed a country to impose quantitative restrictions on trade for not only protecting its exchange reserves but also its domestic programmes relating to price supports and production controls etc.
- **Consultation:** It was expected that trade disputes among nations would be solved through mutual consultations within the GATT framework.
- **Export subsidies and state trading:** Similarly, GATT prohibited export subsidies but allowed their use under certain exceptions. Also, subject to certain exceptions, state trading was to be non-discriminatory.

WTO comes into being

Uruguay Round was the eighth round of GATT negotiations. The Uruguay Round of GATT negotiations (held at Punta de Este) occupy a unique place in the evolution of negotiated rules governing international trade and other inter-country transactions. The conclusion of this Round resulted in the demise of GATT and its replacement with the World Trade Organization which incorporated the GATT rules and much more. The Uruguay negotiations were finalised on 15 December 1993. It was signed on 15 April 1994 at Marrakesh, Morocco to ratify the results of the Uruguay Round. As a result of this, the WTO became operative on 1 January 1995.

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The signing of the concluding agreement of Uruguay Round established the institution called the World Trade Organization (WTO), which is a single multilateral framework encompassing:

- the GATT, as modified by the Uruguay Round,
- all agreements and arrangements concluded under its auspices, and
- the complete results of the Uruguay Round.

Agreements establishing the WTO

- General Agreement on Tariffs and Trade
- Uruguay Round Protocol GATT 1994
- Agreement on Agriculture
- Agreement on Sanitary and Physio sanitary Measures
- Decision on Measures Concerning the Possible Negative effects of the Reform Programme of Least Developed and Net Food Importing Developing Countries
- Agreement on Textiles and Clothing
- Agreement on Technical Barriers to Trade
- Agreement on Trade Related Investment Measures (TRIMs)
- Agreement on Implementation of Article VI (Anti-dumping)
- Agreement on Implementation of Article VII (Customs Valuation)
- Agreement on Pre-shipment Inspection
- Agreement on Rules of Origin
- Agreement on Import of Licensing Procedures
- Agreement on Subsidies and Countervailing Measures
- Agreement on Safeguards
- General Agreement on Trade and Services (GATS)
- Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs), including Trade in Counterfeit Goods
- Understanding on Rules and Procedures Governing the Settlement of Disputes
- Decision of Achieving Greater Coherence in Global Economic Policy-making.

Membership and obligations

WTO came into existence with a membership of 125, which increased to 157 in August 2012, when Vanuatu joined the world trade body. Since 2016, there are 164 members with the WTO.

A country can be a member of WTO only by accepting all the negotiated conclusions, agreements and arrangements of the Uruguay Round of GATT without exception. It does not have the option to opt out of any one agreement or claim exceptions. That way, it is a "Treaty of Treaties".

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WTO provides for further negotiations (both on existing subjects and new ones that may be introduced) which may impose fresh obligations on members. An indication to this effect was given at Marrakesh itself by the representatives of the European Community and US with specific mention of environmental protection and labour standards. Along with the continuing negotiations on existing matters, provision has been made for inclusion of negotiations on fresh areas. By implication, through unending negotiations, the developing countries would remain under intense pressure to yield more and more ground to the developed countries.

WTO is a comprehensive and extensive set of agreements. It is obligatory for each member country of WTO to accept all agreements, bindings and commitments in total and without exception. There is no provision for pick and choose. Also, existing agreements may be modified through further negotiations, and negotiations may be conducted for agreements on new subjects, in future.

14.3.2 Goals and Principles

The following are the primary goals of WTO:

(i) Administering and implementing the multilateral trade agreements which together constitute WTO

(ii) Functioning as a platform for multilateral trade negotiations

(iii) Seeking to settle trade disputes

(iv) Overseeing trade policies of member-countries

(v) Cooperating with other international institutions dealing in global policy-making

Principles

WTO formulates a framework for trade policies; it does not define or specify outcomes. It has to set the rules of the trade policy game and not the results of the game. For almost fifty years, key provisions of GATT did not allow discrimination among members and between imported and domestically produced merchandise. In 2000, WTO had fourty councils, committees, subcommittees, bodies and standing groups or working parties functioning under its auspices. This was twice the number of such bodies under GATT. Although all these bodies, committees, subcommittees, etc. are open to all WTO members, usually only the more important trading countries send representatives for the meetings on a regular basis. The degree of participation points out a mix of national interests and resource constraints. The least developed countries, in particular, ignore these meetings and hence do not have their delegates based in Geneva.

There are certain principles which are of special importance as far as understanding both the pre-1994 GATT and WTO are concerned: (i) non-discrimination, (ii) reciprocity, (iii) enforceable commitments and (iv) transparency.

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i. Non-Discrimination

The Most Favoured Nation (MFN) rule and the National Treatment Principle (NTP) are the two major components of non-discrimination. Although both of them are embedded in the basic WTO rules relating to goods, services and intellectual property, there are differences in their precise scope and nature. According to Article I, the famous 'Most Favoured nation' (MFN) clause, members are bound to grant the products of other members a treatment no less favourable than that accorded to the products of any other country. Hence, no country can give special trading advantages to another or to discriminate against it; all are equal and all share the benefits of any moves towards lower trade barriers. MFN treatment usually makes sure that developing countries and others having little economic leverage are to benefited by the best trading conditions – wherever and whenever they are negotiated.

'National treatment' is another form of non-discrimination. It requires that once goods have reached a market, they must be considered no less favourably than the equivalent domestically manufactured goods. It also requires that foreign goods, after they have satisfied whatever border measures are used, be treated no less favourably—in terms of internal (indirect) taxation—than like or directly competitive domestically produced goods (Article III, GATT). In other words, goods of foreign origin circulating in the country must be subject to taxes, charges and regulations that are 'no less favourable' than those that apply to similar goods of domestic origin.

ii. Reciprocity

Reciprocity is one of the basic elements of the negotiating process. It reflects that both the parties are ready to limit the scope for free-riding that may arise owing to the MFN rule and want to procure 'payment' for trade liberalization in the form of better access to foreign markets. In today's trade setting, being able to point to reciprocal, sector- specific export gains may help to politically sell liberalization. You should note that reciprocal concessions ensure that such gains materialize.

iii. Binding and Enforceable Commitments

Liberalization commitments and agreements do not have any significant value if they are not enforceable. The non-discrimination principle embodied in Articles I (on MFN) and III (on national treatment) of GATT, is important for ensuring that market access commitments are executed and maintained. Other GATT articles have a supportive role, including Article II (on schedules of concessions). The tariff commitments made by WTO members in a multilateral trade negotiation and on accession are identified in schedules (lists) of concessions. These schedules establish 'ceiling bindings', i.e., the member concerned cannot raise tariffs above bound levels without negotiating compensation with the principal suppliers of the products concerned. Once the tariff commitments are bounded, it is significant to make sure that there is no resort to other non-tariff measures that can nullify or impair the value of the tariff concession.

iv. Transparency

In order to enforce commitments, access to information on the trade regimes maintained by members is essential. These agreements administered by WTO, therefore, incorporate mechanisms designed for facilitating communication between WTO members on these issues.

Several other WTO agreements contain important provisions on Trade-Related Aspects of Intellectual Property Rights (TRIPS) – with some exceptions, and MFN and national treatment requirements relating to the provision of intellectual property protection by WTO members. GATTs requires members to offer MFN treatment to services and services suppliers of other members, while, national treatment is an obligation in GATTS where members explicitly undertake to accord it for particular service activities. This means that a national treatment often results due to negotiations among members.

14.3.3 Organizational Structure

In WTO, decisions are made by the entire membership. Each member country has one vote irrespective of the size of its economy and share in world trade. A decision or agreement becomes binding only when all members accept it. Top level decision-making body of WTO is the Ministerial Conference which meets at least once in two years. In addition, a General Council monitors the operation of the agreement and ministerial decisions on a regular basis by meeting several times a year. The General Council normally comprises heads of delegations and ambassadors, though in effect, the task may be delegated to officials. The Council also acts as a Dispute Settlement Body and a Trade Policy Review Mechanism. In these two capacities, the General Council deals with full range of trade issues covered by the WTO. For this purpose, it functions through subsidiary bodies like a Goods Council, a Services Council and a TRIPs Council. Moreover, numerous specialised committees and working groups deal with individual agreements and other areas (such as, membership applications, regional trade, environment and development).

14.3.4 Areas of Operation

The important areas of WTO operations may be discussed under the following heads:

i. Agreement on Agriculture (AoA)

Agriculture is one of the most difficult areas which WTO has to deal with. Its difficulties originate from several sources. A large number of poorer countries are heavily dependent upon agriculture and a major portion of their populations is dependent upon low-income (and sometime bare subsistence) farming. They also face the problems of poverty and "food security". In fact, these countries have been placed at a great disadvantage by farm policies pursued by the rich countries. The latter are doling out huge subsidies to their farm sectors. Consequently, the

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poorer countries are not able to compete with them in international markets. Attempts through UNCTAD, etc., also meet with little success in improving their terms of trade and export earnings. In addition, the developed countries, particularly the US and EU, have persisted with their farm-support policies. Since the establishment of WTO, instead of reducing farm subsidies, they have further enhanced them.

In substance, there are four primary issues relating to trade in agriculture:

a) Reduction (preferably total removal) of Domestic Support to Farm Sector
b) Reduction in Export Subsidies
c) Greater Access to Markets (that is, reducing import restrictions by importing countries)
d) Special and Differential Treatment for Developing Countries

In addition, there are also the issues relating to the Agreement on Sanitary and. Physio sanitary Measures.

***a) Domestic support*:** WTO classifies domestic support in agriculture into 3 "boxes" (or categories) as follows:

- *Amber Box,* that is, those subsidies that distort trade and must be reduced.
- *Green Box,* that is, those subsidies that cause a "minimal" distortion of trade and can be continued without limits.
- *Blue Box,* that is, subsidies given under the exemptions to the general rule that all subsidies linked to production must be reduced. Some countries would like the blue box to be scrapped.

  Developed countries have been finding ways to avoid implementation of their commitments to reduce and eventually scrap agricultural subsidies.

  Currently, for example, US and EU countries are subsidising their farm sectors at the rate of nearly one billion dollars a day. Critics claim that the developed countries would never approve of policies which could strengthen the agriculture of the poorer countries.

***b) Reduction in export subsidies*:** While poor countries cannot afford to heavily subsidise their agricultural exports, the richer countries are doing so in different ways such as subsidising export credit and doling out of farm incomes which are "unrelated to production".

***c) Market access*:** Not much success has been achieved in the area of market access. Though quantitative restrictions have been removed, their place has been taken by tariffs in virtually all agricultural trade between WTO members. Generally, two rates of tariffs are being allowed, viz., lower rates for imports up to the scrapped quota volumes

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and higher rates for imports in excess of the quota quantities. Negotiations have been taking place for liberalising trade and reducing tariffs rates, but without much success.

d) ***Differential treatment*: ** WTO recognises the need for special and differential treatment for developing countries. But developing countries themselves often disagree over what they want, though there are some problems that are common to all of them. In general, all countries exporting agricultural produce want easier access to the markets of importing countries. However, the developing countries want a "fair competition" with non-subsidised agricultural produce of the developed countries. In contrast, the developed countries want to continue with their huge subsidies and "free competition" between their own produce (which is subsidised) and produce of the developing countries (which they insist should be non-subsidised). They also want that developing countries should reduce tariffs and other restrictions on their imports. As against this, countries like Japan simply refuse to lower import restrictions.

AoA is considered highly unfair to the poorer countries because they have to face a flood of heavily subsidised imports from developed countries and thus suffer in terms of large-scale reduction in rural incomes and employment, as also weakening of food security. It is more so because the exports from the US and EU countries are mainly surplus products. The inability of developing countries to satisfy the conditions of the Agreement on Sanitary and Physio sanitary Measures (safety and health regulations of plants and animals) is an added potential handicap for them.

Agriculture is one of the most difficult areas for the WTO. It is partly so because of the very nature of the subject, and partly because of the entrenched vested interests. For these reasons, problems related to agriculture still defy a satisfactory outcome.

ii. Agreement on TRIMs

The Agreement on Trade Related Aspects of Investment Measures (TRIMs) recognises that certain investment measures restrict and distort trade. The Agreement says that no contracting party shall apply any TRIM which is inconsistent with Article III (national treatment) and Article XI (prohibition of quantitative restrictions) of GATT. Such inconsistent measures include prescribing particular levels of local procurement by an enterprise, etc. The Agreement requires mandatory notification of all non-conforming TRIMs and their elimination within two years by developed countries, within five years by developing countries, and within seven years by least developed countries.

iii. Agreement on Anti-dumping

Rules for anti-dumping steps which an importing country could take were already there. This Agreement provided certain elaborations, clarifications and revisions of those rules.

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iv. Agreement on Pre-shipment Inspection

Under this provision, an importing country can ascertain details of quantity, quality, price and other aspects of the incoming imports at shipment level. Note that this provision has been extensively used by USA after the terrorist attack of 11 September 2001.

v. Agreement on Subsidies and Countervailing Measures

This Agreement establishes three categories of subsidies:

(a) Some subsidies are deemed "prohibited". They include those which affect export performance, and those which affect competitiveness of imports vis-a-vis domestic production. Prohibited subsidies are subject to new dispute settlement procedures. Recognising the role of subsidies in economic development, the Agreement allows the developing and least developed countries a time-bound use of prohibited subsidies.

(b) "Actionable" subsidies, i.e. those subsidies which cause injury to the producers of another member country.

(c) The third category is of "non-actionable" subsidies, such as non-specific subsidies, or subsidies at research level, and the like.

As regards countervailing measures on subsidised imports, it provides details of the procedure of determining the justification of such measures and the manner and extent of their use.

vi. Agreement on Trade in Services

This agreement is for extending the principles of open trade as available for trade in goods to trade in services. This includes companies in the area of insurance, telecommunications, tour, travel, transport, banking, hotels, etc. The member nations have also specified individually which sectors are open for foreign competition and the level till which the markets are open for them.

vii. Agreement on TRIPs

This Agreement recognises the widespread presence and trading of counterfeit goods, and the need to have rules and discipline in their international trade. It provides that a member country shall accord as much protection to the intellectual property of foreigners as it accords to the intellectual property of its own nationals, or nationals of one foreign country would not be granted less protection than nationals of some other foreign country. It also addresses property rights relating to individual categories, such as copyrights (including those of computer programmes, music recordings, and films), trademarks and service marks, industrial designs, patents, trade secrets and know-how, etc. The Agreement sets out obligations of member governments to provide procedures and remedies under their domestic law to ensure that intellectual property rights are effectively enforced.

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viii. Dispute Settlement

The dispute settlement of GATT is generally considered to be one of the cornerstones of the world trade order. It had already been strengthened and streamlined in December 1988 at the Ministerial meeting. The UR further strengthened it by making it more automatic and by incorporating consultations, etc.

ix. Trade Policy Review Mechanism

This agreement confirmed the already existing Trade Policy Review Mechanism. It encouraged greater transparency in national trade policy-making. Detailed procedures were to be introduced later.

x. Plurilateral Trade Agreements

These are part of the larger WTO agreement. Unlike the Multilateral Trade Agreements, they are not binding on all members. They apply only to those members which have accepted them. Examples of such agreements include those on trade in civil aircraft, on government procurement, on dairy bovine meat, and the like. Some of them were included for multilateral agreements under agenda for later Ministerial Conferences of WTO. Examples of measures so included in agenda are 'investment', ''transparency in government procurement', 'competition policy', 'labour standards', and so on.

Check Your Progress

3. Which round of GATT negotiations replaced it with WTO?
4. Who makes the decisions in the WTO?
5. What does the Agreement on TRIMs says?

14.4 OPEC

The Organization of the Petroleum Exporting Countries (OPEC) is a permanent, intergovernmental Organization, created at the Baghdad Conference between 10–14 September 1960, by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela.

The five Founding Members were later joined by nine other Members: Qatar (1961); Indonesia (1962) – suspended its membership in January 2009, reactivated it in January 2016, but decided to suspend it again in November 2016; Libya (1962); United Arab Emirates (1967); Algeria (1969); Nigeria (1971); Ecuador (1973) – suspended its membership in December 1992, but reactivated it in October 2007; Angola (2007); and Gabon (1975) - terminated its membership in January 1995 but rejoined in July 2016. OPEC had its headquarters in Geneva, Switzerland, in the first five years of its existence. This was moved to Vienna, Austria, on 1 September 1965.

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This is to say that the OPEC has 13 member countries in total.

OPEC's objective is to co-ordinate and unify petroleum policies among Member Countries, in order to secure fair and stable prices for petroleum producers; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry.

14.4.1 Origin

Let's trace the origins and work of OPEC over the years.

The 1960s

OPEC's formation by five oil-producing developing countries in Baghdad in September 1960 occurred at a time of transition in the international economic and political landscape, with extensive decolonisation and the birth of many new independent states in the developing world. The international oil market was dominated by the 'Seven Sisters' multinational companies and was largely separate from that of the former Soviet Union (FSU) and other centrally planned economies (CPEs). OPEC developed its collective vision, set up its objectives and established its Secretariat, first in Geneva and then, in 1965, in Vienna. It adopted a 'Declaratory Statement of Petroleum Policy in Member Countries' in 1968, which emphasized the inalienable right of all countries to exercise permanent sovereignty over their natural resources in the interest of their national development. Membership grew to ten by 1969.

The 1970s

OPEC rose to international prominence during this decade, as its Member Countries took control of their domestic petroleum industries and acquired a major say in the pricing of crude oil on world markets. On two occasions, oil prices rose steeply in a volatile market, triggered by the Arab oil embargo in 1973 and the outbreak of the Iranian Revolution in 1979. OPEC broadened its mandate with the first Summit of Heads of State and Government in Algiers in 1975, which addressed the plight of the poorer nations and called for a new era of cooperation in international relations, in the interests of world economic development and stability. This led to the establishment of the OPEC Fund for International Development in 1976. Member Countries embarked on ambitious socio-economic development schemes. Membership grew to 13 by 1975.

The 1980s

After reaching record levels early in the decade, prices began to weaken, before crashing in 1986, responding to a big oil glut and consumer shift away from this hydrocarbon. OPEC's share of the smaller oil market fell heavily and its total petroleum revenue dropped below a third of earlier peaks, causing severe economic hardship for many Member Countries. Prices rallied in the final part of the decade, but to around half the levels of the early part, and OPEC's share of

NOTES

newly growing world output began to recover. This was supported by OPEC introducing a group production ceiling divided among Member Countries and a Reference Basket for pricing, as well as significant progress with OPEC/non-OPEC dialogue and cooperation, seen as essential for market stability and reasonable prices. Environmental issues emerged on the international energy agenda.

The 1990s

Prices moved less dramatically than in the 1970s and 1980s, and timely OPEC action reduced the market impact of Middle East hostilities in 1990–91. But excessive volatility and general price weakness dominated the decade, and the South-East Asian economic downturn and mild Northern Hemisphere winter of 1998–99 saw prices back at 1986 levels. However, a solid recovery followed in a more integrated oil market, which was adjusting to the post-Soviet world, greater regionalism, globalisation, the communications revolution and other high-tech trends. Breakthroughs in producer-consumer dialogue matched continued advances in OPEC/non-OPEC relations. As the United Nations-sponsored climate change negotiations gathered momentum, after the Earth Summit of 1992, OPEC sought fairness, balance and realism in the treatment of oil supply. One country left OPEC, while another suspended its Membership.

The 2000s

An innovative OPEC oil price band mechanism helped strengthen and stabilise crude prices in the early years of the decade. But a combination of market forces, speculation and other factors transformed the situation in 2004, pushing up prices and increasing volatility in a well-supplied crude market. Oil was used increasingly as an asset class. Prices soared to record levels in mid-2008, before collapsing in the emerging global financial turmoil and economic recession. OPEC became prominent in supporting the oil sector, as part of global efforts to address the economic crisis. OPEC's second and third summits in Caracas and Riyadh in 2000 and 2007 established stable energy markets, sustainable development and the environment as three guiding themes, and it adopted a comprehensive long-term strategy in 2005. One country joined OPEC, another reactivated its Membership and a third suspended it.

2010 until now

The global economy represented the main risk to the oil market early in the decade, as global macroeconomic uncertainties and heightened risks surrounding the international financial system weighed on economies. Escalating social unrest in many parts of the world affected both supply and demand throughout the first half of the decade, although the market remained relatively balanced. Prices were stable between 2011 and mid-2014, before a combination of speculation and oversupply caused them to fall in 2014. Trade patterns continued to shift, with demand growing further in Asian countries and generally shrinking in the OECD. The world's focus on multilateral environmental matters began to sharpen, with

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expectations for a new UN-led climate change agreement. OPEC continued to seek stability in the market, and looked to further enhance its dialogue and cooperation with consumers, and non-OPEC producers.

14.4.2 Organizational Structure

There are four elements which make up the organizational structure of the OPEC:

- The Conference
- The Board of Governors
- The Economic Commission
- The Secretariat

Let's discuss each of these briefly:

The Conference

The Heads of Delegations of member countries meet twice a year for discussions. These heads of delegations are the portfolio level ministers usually from Ministry of Petroleum, Oil and Energy or equivalent. Its many functions include formulation of policy, decisions on application of membership, decisions on recommendations by Board of Governors, approval of appointment of governors, etc.

The Board of Governors

This is made up of one governor nominated by every member country which is confirmed by the Conference for the period of two years. Its functions include management, implementation of resolutions, preparation of budgets, recommendations for the Conference.

The Economic Commission

This constitutes the Secretary General, National Representatives from member countries and a Commission Coordinator (who is ex-officio the Director of the Research Division). This is a special body functioning under the Secretariat. Its main aim is the promotion of stability in the oil markets on the international level.

The Secretariat

This is an executive body which ensures implementation of functions as directed by the Statute and the Board of Governors. The Secretary General is the head of this body and it has many other staff working for it. It constitutes three different offices including the Secretary General's office, the Research Division and the Support Services Division.

Check Your Progress

6. Who were the founding members of OPEC?
7. What is the Economic Commission in the OPEC?

14.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. The UNCTAD conference meets once in four years. The first conference took place in Geneva in 1964.
2. The common fund as it stands now has two windows. The first window finances the buffer stock operations of certain primary products, while the second window finances the promotional activities relating to product development and marketing.
3. Uruguay Round was the eighth round of GATT negotiations. The conclusion of this Round resulted in the demise of GATT and its replacement with the World Trade Organization which incorporated the GATT rules and much more.
4. In WTO, decisions are made by the entire membership. Each member country has one vote irrespective of the size of its economy and share in world trade. A decision or agreement becomes binding only when all members accept it.
5. The Agreement on Trade Related Aspects of Investment Measures (TRIMs) recognises that certain investment measures restrict and distort trade. The Agreement says that no contracting party shall apply any TRIM which is inconsistent with Article III (national treatment) and Article XI (prohibition of quantitative restrictions) of GATT.
6. Iran, Iraq, Kuwait, Saudi Arabia and Venezuela were the five founding members of the OPEC.
7. The Economic Commission constitutes the Secretary General, National Representatives from member countries and a Commission Coordinator (who is ex-officio the Director of the Research Division). This is a special body functioning under the Secretariat. Its main aim is the promotion of stability in the oil markets on the international level.

14.6 SUMMARY

- The United Nations Conference on Trade and Development (UNCTAD) was established in 1964 in order to provide a forum where the developing countries could discuss the problems related to their economic development.
- The primary objective of UNCTAD is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology.
- Major achievements of the UNCTAD include the implementation of the Generalized System of Preferences (GSP) and creation of the common fund.
- The World Trade Organization (WTO) provides the basic framework for conduct of international trade and sets up the norms for the conduct of such trade.

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- The Uruguay Round of GATT negotiations (held at Punta de Este) occupy a unique place in the evolution of negotiated rules governing international trade and other inter-country transactions. The conclusion of this Round resulted in the demise of GATT and its replacement with the World Trade Organization which incorporated the GATT rules and much more.
- WTO is a comprehensive and extensive set of agreements. It is obligatory for each member country of WTO to accept all agreements, bindings and commitments in total and without exception. There is no provision for pick and choose. Also, existing agreements may be modified through further negotiations, and negotiations may be conducted for agreements on new subjects, in future.
- There are certain principles which are of special importance as far as understanding both the pre-1994 GATT and WTO is concerned: (i) non-discrimination, (ii) reciprocity, (iii) enforceable commitments and (iv) transparency.
- Important areas of work in WTO include Agreement on Agriculture, Agreement on TRIMs, Agreement on Anti-dumping, Agreement on Pre-shipment Inspection, Agreement on Subsidies, Dispute settlement etc.
- The Organization of the Petroleum Exporting Countries (OPEC) is a permanent, intergovernmental Organization created at the Baghdad Conference between 10–14 September 1960, by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. The five Founding Members were later joined by nine other Members.
- OPEC's objective is to co-ordinate and unify petroleum policies among Member Countries, in order to secure fair and stable prices for petroleum producers; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry.
- There are four elements which make up the organizational structure of the OPEC: The Conference, the Board of Governors, the Economic Commission and the Secretariat.

14.7 KEY WORDS

- **Generalized System of Preference:** It is a scheme of UNCTAD under which exports of manufactures, semi-manufactures and certain agricultural items from the developing countries enter the developed countries either free of duty or at reduced rates.
- **Most favoured nation:** It is a principle of WTO, which means that if a country extends better trade treatment to one country, it extends it indiscriminately to all Contracting Parties of GATT.
- **National treatment:** It is a form of non-discrimination principle of WTO which requires that once goods have reached a market, they must be considered no less favourably than the equivalent domestically manufactured goods.

- **Dumping:** It is a situation of international price discrimination, where the price of a product when sold in the importing country is less than the price of that product in the market of the exporting country.

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14.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the divisions under which the UNCTAD works?
2. Write a short note on the membership of the WTO.
3. What are the constituents of OPEC's organizational structure?

Long Answer Questions

1. Explain the systems of GSP and Common fund under the UNCTAD.
2. Describe the origins of the WTO and its basic principles of GATT.
3. Discuss the goals and principles of WTO.
4. Assess the important areas of WTO operations.
5. Discuss the origin and history of OPEC.

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